

the law

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LOOKING TO SELL YOUR LAW FIRM?

Contact us for a
confidential chat about
how to go about it

CONTACT **ANDY POOLE** FOR MORE INFORMATION
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WELCOME

Welcome to the Autumn 2023 edition of The LAW, the specialist publication for the legal profession from the legal sector team at Armstrong Watson.

As last quarter, concerns remain around the wider economy and the potential impact on law firms. Although firms are generally still performing well, there has been a noticeable drop in transaction volumes. This edition of The LAW therefore has a deliberate leadership and management feel about it, helping law firms to navigate through these changeable times.

This edition includes such articles on

- the five building blocks that any business needs to have to be successful
- measuring financial performance
- managing financial performance
- an interview on leadership with Charles Layfield.

It also includes articles on becoming an ABS; planning for merger/disposal; funding your tax bills; and the top SRA Accounts Rules breaches.

Specialists are available from all of our 18 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.

To find out more on any of the above, including how we can work with you to help you and your clients, please do get in touch with me.



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GENERATING TRACTION FOR YOUR LAW FIRM



As a law firm leader, do you have big plans and ideas? Do you have a team that needs to go on a journey with you? How do you generate accountability in order to create real traction?

For any business to succeed, there are five fundamental building blocks that need to be in place:

1. **Vision**
2. **People**
3. **Process**
4. **Data**
5. **Management**

Here at Armstrong Watson, we understand there is no magic recipe or wand when it comes to Strategic Business Planning. We find our most successful clients invest time ON their business instead of time IN their business.

Our aim is to get business owners focused on long-term strategic goals via effective step by step planning that in turn will deliver tangible results giving the flexibility to stay ahead of the competition.

The internet is full of advice and what to do information, but very few services are positioned to offer personal 1on1 time tailored to fit a business efficiently and effectively with measured results and outcomes along the way.

When we provide Strategic Business Consulting to law firms, we help law firm owners create their Vision, around which all other business decisions are focussed. This allows us to then turn to the other key building blocks of:

- **having the right People in the right roles with the right skill-sets;**
- **developing the right Process for people to follow in a consistent and effective manner, covering all internal and external roles;**
- **agreeing the right Data that allows performance to be measured, behaviours to be corrected and business decisions to be taken effectively; and**
- **creating and facilitating the most appropriate Management Structure for all of this to be monitored and for agreeing, allocating and monitoring specific actions to create success.**

All of this is broken down into manageable steps.

Our Advance Strategic Planning Service is designed to optimise this process via a trusted system enabling you to remain focused and on-track with your business giving you the confidence that support and advice is on hand throughout.

The value is in the structure and clarity that comes from the commercial, strategic and specific legal sector expertise of Armstrong Watson. No individual law firm is the same, and the actions that result from our Advance consulting are different for each firm we consult with – but under-pinning that there needs to be structure, continuity and overall an effective Business Management Structure that ensures the most appropriate tasks are undertaken and followed through.

All too often, law firms have people focusing on the wrong priorities for the business; and even more often law firms allocate tasks to individuals or departments that never get completed. To succeed in a competitive legal business landscape, time and energy needs to be focused rather than wasted and there needs to be an environment of accountability in order to make sure that progress is made.

At the heart of our offering is the relationship that we build with our clients. Our initial focus is with the business owners by understanding your current position and guiding you on your journey, all tailored to your business needs and aspiration.

“ We have been really impressed by Andy and the strategic consulting team. They have empowered us to transform the way that we think of our firm and supported us to make difficult decisions which have transformed our growth and profitability.

We now have a clear goal, and we are well on our way to achieving it.

The big advantage that Andy offers is his experience and knowledge. Many people claim that their plans could work, Andy knows that theirs does. It is not easy, it requires discipline. They offer practical assistance, advice, support and encouragement, praise in the good times and hold us accountable in the bad.

Plus, Andy is a really decent guy, good fun and you can tell he loves his work. I would strongly recommend them to any law firm looking to thrive in the current and future market.

NICHOLAS SCULLION
SCULLION LAW - GLASGOW



The journey begins with a full day consulting session on your Vision, allowing your management team to collectively agree on where you are now, what you would like to achieve, what you could achieve and the key matters that need to be addressed to obtain success. With action plan output, this is the ideal way for you to take stock and could potentially be used as a partner away day.

Costs start at £5,195+VAT for this session – further details can be found at:

<https://www.armstrongwatson.co.uk/sectors/legal-sector/strategic-business-advice-law-firms>

Contact me if you'd like to discuss this in more detail and find a way to allow your firm to obtain traction.

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WHY IS MANAGEMENT INFORMATION SO IMPORTANT?



There are numerous reasons why your Firm should have a variety of sources of key Management Information ("MI") and what those sources should be, will depend on the specific requirements of your Firm. The important point is that the MI produced should be "Quality not Quantity" and should always be accurate, relevant, timeous and systemised. For some Firms, there will be key pieces of financial or other data that are produced on a daily or weekly basis that aid decision making or prompt further investigation. Some Firms will create live MI, while other Firms may only require monthly figures. We will explore some specifics below.

Your Early Warning System

A reliable source of accurate MI will assist greatly in identifying performance against your Budgets, areas of overspend, aspects of underperformance or simply incorrect internal accounting allocations or adjustments. The more quickly that MI can be available, the earlier issues can be identified and corrective action taken. Core accounting information can be supplemented by a wider range of Key Performance Indicators ("KPI's"), for example:-

- Chargeable utilisation
- Recovery rates
- Debtor days
- Work in Progress days
- Gross profit %
- Conversion rates
- Success rates
- Case life-span
- Stage of case life-span
- Client satisfaction

Not an exhaustive list, and individual Firms can design additional KPI's that are particularly relevant to them.

Budget Setting

Your Firm will typically set a Budget including cash flow projections for the year ahead, and this becomes an important piece of MI as you compare actual results when they accumulate throughout the year. With rising inflation and other factors facing the economy, it may be necessary to flex your Budget throughout the year on more than one occasion.

Combating inflation and maintaining profit margins

We all know the pressures that are facing businesses and individuals with high inflation, high interest rates and rising Corporate and Personal Taxation. All of these factors are likely to suppress demand for legal services from both businesses and consumers, with economic growth likely to remain flat over the next two years, and the possibility of a technical recession looming. Staying robust on your pricing will be key however, and being brave enough to increase your pricing given the specific inflationary pressures your Firm is likely to be facing on such areas as staff costs, energy costs and PI Insurance. In our own

experience, our clients generally understand that our pricing has to increase to combat rising costs, so you may well find that there is not as much resistance as you expect. Cost control will be very challenging while inflation generally and sector inflation specifically increases your cost base.

Accurate MI will be a key management tool in monitoring your costs and highlighting areas of possible savings by reviewing suppliers and negotiating better prices. We know that many Firms are undertaking a line by line review of all of their overheads, but care must be taken to trim the "fat" but not cut into the operational "muscle" of your business.

Maintaining recovery rates and seeking out operational efficiencies will also assist in defending or improving your bottom line profits in real terms and only a robust and reliable system of producing the right MI will enable this. What gets measured gets done.

Benchmarking statistics from a pool of similar Firms can also be a powerful way of ensuring that your performance as indicated by your MI is not out of line with your peer group of Firms.

Cash is King

You will no doubt have heard the saying – "Turnover is vanity, Profit is sanity, but only Cash pays the bills". Achieving profitable top line growth is an admirable ambition at any time, but to avoid "over-trading", Work in Progress needs to be turned into fees as quickly as possible, just as fees need to be turned into cash with minimum credit terms. A growing business always needs additional working capital and strong MI can identify this working capital requirement in advance, which will also impress funders to whom you may look to provide lending facilities to support that growth. This is particularly important where there are signs of an increasing number of businesses reaching financial distress and fee debtor days may be lengthening as cash resources tighten throughout the economy. Again, the appropriate MI and KPI's can be used as an early warning system, so as to tackle any problem cases as early as possible.

Cash flow forecasting on a rolling 12 week basis will be an essential tool in monitoring the adequacy of cash reserves, and measuring against the annual cash flow targets. Some contingency planning based on some adverse sensitivities or "stress testing" is also useful to predict "worst scenarios".

Interest rates

One of the upsides of rising interest rates, particularly for Firms that are not borrowing heavily, is the ability to generate significant additional income from monies on the general Client Account. Obtaining the best interest rates possible should be a priority, but there is a danger that the windfall to interest income, profits and cash flow this brings, may mask other areas of underperformance in your Firm. The "comfort blanket" of interest income propping up the profits of your Firm may expose the Firm to difficulties when interest rates start to drop again over the coming years as anticipated. While interest income will in itself be a key piece of MI to monitor, focus must remain on the long term profitability and sustainability of the underlying business. Robust MI reporting will help to keep that focus.

Summary

It is fair to say that the last few years have seen an unprecedented and varied series of challenges for those of us in business. It certainly means that planning ahead and budgeting can be difficult, but we also know from historic recessions and the 2008 financial crisis that the "survival of the fittest" is always true. Indeed there may be great opportunities for Firms that come out of the next two years in good shape when, as it will, the economic recovery builds momentum. Your Firm will have much more chance of being in good shape if you are able to capitalise on, and react to, the early warning system that your MI systems can produce.

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MANAGING FINANCIAL PERFORMANCE: LAW FIRMS - KEY ROLES

This is the second part of our published article in Practical Law, the full article can be found at www.practicallaw.com and the first part of the article can be found in a previous edition of the LAW.

Roles of compliance officer for finance and administration and financial director.

Most small or medium sized enterprises (SMEs) struggle to employ a full-time finance director (FD) (although part-time and outsourced FDs are available) and commonly the compliance officer for finance and administration (COFA) is a partner in the firm performing other roles (see Roles of compliance officer for legal practice, COFA, FD and internal teams: how they overlap). Conversely, in large firms this could be three people: an FD, a COFA and the equity partner in charge of finance. Nonetheless, the basic role remains the same and is the distillation of the three building blocks above: safeguard the firm's assets, increase profitability wherever possible and ensure there is always sufficient cash.

Roles of other members of the finance team

Even in the smallest of law firms there will be other members of a finance team (although they may not be full time, or could be part of an outsourced function). Many of these roles are transactional and so their primary duty is to ensure that cashiering, nominal postings, and payments are processing in an accurate and timely manner.

Roles of compliance officer for legal practice, COFA, FD and internal teams: how they overlap

All of these people (albeit in SMEs, this might be one person) have a part to play in reviewing and managing the firm's performance. However, a sensible deconfliction of duties might be:

- **COFA** this role is required by the SRA and the COFA is primarily responsible for client money and its protection. This role will likely be focused on reconciling movements within the client account(s) and ensuring the SRA Accounts Rules are followed and any breaches remedied quickly.
- **FD** primarily responsible for office money and its continued growth and cashflow monitoring. Many of the points, noted in the first part of this article series, in terms of the three building blocks (assets, profits, and cash) will fall to them in the first instance.
- **Internal audit** usually the "eyes" of the FD and COFA; this team might perform ad-hoc reviews, file monitoring or thematic examinations of areas that are underperforming. Many firms do not have internal audit teams but can still replicate this function via nominated non-finance staff or external specialists.

- **External audit or accountancy firms** many firms assume their nominated external audit or accountancy firm is performing a risk monitoring function. It is true that as a by-product of their work they often spot things that the internal people do not, and if you are using expert legal sector accountants, they can also bring some of that sector knowledge, in terms of best practices and industry norms. However, ultimately audit or accountancy external firms are there to fulfil their obligations to their own regulators, not the firm's obligations to the SRA. The SRA would take a dim view of any firm attempting to outsource responsibility in this way.

- **Compliance officer for legal practice (COLP)** this role is required by the SRA and the COLP is primarily responsible for compliance with the broader *SRA Standards and Regulations* (StaRs). Within larger firms, the COLP will often sit within the risk and compliance team. The COLP will inevitably take an interest in any areas where the SRA Accounts Rules are at risk of being breached and of overall financial stability. They many also find themselves in opposition (if not outright conflict) with the FD where decisions must be made that have a positive impact on quality but a negative impact on costs.

Role of firm's owners

It is likely that owners who are not in one of the finance related roles will still be interested in the decisions being taken. Moreover, in extreme circumstances they might be the ones with money at risk if a firm is unable to pay out previously undrawn profits. However, in the interests of streamlining management decisions and not creating a scenario where too much time is spent discussing options rather than acting, it is usually best practice that

actual day to day decision making is delegated to the roles noted above. This means there is a requirement for the owners to have a feedback loop which allows them access to regular, timely and insightful information and to be able to query and challenge decisions being taken on their behalf.

Role of other fee earners

Every fee earner has their individual part to play in building a robust finance function for the firm. Fee earners are raising bills, authorising transfers from client accounts, chasing bad debts and writing off irrecoverable amounts (whether WIP or debtors) on a daily basis. Perhaps more than any other sector, those "at the coalface" can have a bigger daily impact on the profits, assets and cashflow of the firm. Accordingly, they should be empowered to understand their role and the effect it can have, to ask for support or guidance from the FD or COFA as required and to have open and honest conversations about their expected actions as well as support in training where they have skill gaps.

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Contact Andy Poole via andy.poole@armstrongwatson.co.uk if you would like assistance with any of the topics raised in this series of articles.

FUNDING YOUR TAX BILLS



Following the changes to the basis period being implemented by HMRC on unincorporated businesses and Limited Liability Partnerships, it is important for affected businesses to assess their circumstances and plan for any impact to their tax payments. The key date when those additional tax liabilities will start to crystallise is 31 January 2025. HMRC will automatically assume that the transitional profits will be spread over 5 tax years starting from 2023/24. Be aware however that any leaving/retiring Partners/Members will crystallise their full remaining liability immediately, as would a change in structure such as full incorporation or a sale of the business.

While most will be able to adapt, these changes will leave some businesses unable to settle their tax bill in full due to working capital limitations, which are already being stretched due to external inflationary factors.

One option, if unable to settle a tax bill, is for businesses to approach HMRC for a Time to Pay (TTP) arrangement. This agrees a formal repayment plan with HMRC to repay the outstanding bill over a number of months. This is usually the most cost-effective way of spreading the liability.

Should HMRC be unable or unwilling to support this request, businesses can utilise specialist funders to borrow the amount required to settle their tax bill.

There are a number of specialist lenders in the marketplace, providing funding for tax or VAT bills, allowing businesses to spread the cost of these bills and reducing the cash flow impact of settling in full.

Typically, loans can be arranged for a maximum of 12 months for tax liabilities and 3 months for VAT bills, meaning the outstanding debt is cleared before the next one becomes due. Businesses can then decide whether to renew their facility or revert to settling bills in full once the lending has been repaid.

As with all lending, it is important to consider the overall costs, which will likely include arrangement fees and interest, as well as any security required to support the lending request. In all situations, businesses are advised to seek advice from their professional advisers to review their options and decide on the most appropriate way forward.

At Armstrong Watson we take time to understand our client's funding requirements, working with them closely to ensure that they obtain the most appropriate and cost-effective funding available.

We have access to over 100 different lenders, providing a wide range of funding solutions. By working with us, you can ensure that you quickly identify all available options before making an informed decision.

Contact our head of funding Stephen Dinsmore if you need to access funding for your tax bills, or for any other business purpose.

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SETTING UP AN ABS



An increasing number of law firms have converted to an ABS model, for the flexibility it offers going forwards. So what are the main pros and cons of an ABS and what is involved in setting one up?

The first ABS licence was granted by the SRA in Spring 2012, since then an increasing number of law firms have converted to this model. Sharon Carr, a legal sector manager in accountants Armstrong Watson, explains the pros and cons of an ABS and what is involved in setting one up.

What is an Alternative Business Structure (ABS)?

An ABS is a law firm that is licensed to carry on one or more of the specific reserved legal activities under the Legal Services Act 2007. An ABS's key point of difference is that its owners and/or managers are not all lawyers, although an ABS must provide a legal service.

High profile conversions to the ABS model include Irwin Mitchell, Kennedys, Parabis, Weightmans and Keoghs.

Why would I set up as/convert to an ABS?

An ABS structure is a necessity when a law firm has a non-lawyer(s) in its ownership and management structure. This includes a non-lawyer(s) being appointed as a company director and shareholder, or a partner in a partnership, or a member in a limited liability partnership.

There is a growing appetite for non-lawyers to be involved in the running of firms, not only to assist in the day-to-day operations including (but not limited to) finance and HR, but also to provide oversight, direction and leadership from an external perspective. Having an ABS structure also creates investment opportunities and the ability to benefit from vertical integration.

What are the advantages?

The main potential advantages include:

- Strengthening the firm's management with a broader range of talent.
- Bringing in equity investment from a bigger pool of potential partners.
- Providing non-legal services to strengthen a firm's offering, enabling diversification and perhaps turning a firm into more of a one-stop-shop for clients.
- Enabling family share ownership (for example, as part of a tax-planning strategy).

Potential risks

The main potential risks include:

- The impact non-lawyer managers or owners could have on the culture of the firm. This needs careful consideration as part of reviewing the business plan and deciding the future direction of the firm.
- If non-lawyers underestimate the obligations of solicitors, particularly the importance of regulatory compliance
- An ABS currently requires at least £3 million cover in the event of a claim, whereas a partnership or recognised sole practice that is not an ABS requires only £2 million of cover.
- If you want to provide services through an office overseas, many foreign jurisdictions may not accept an ABS.

continued...

- Outside investment comes with risk, especially if the investor can easily sell their interest or withdraw their investment.
- New start-up ABSs that lack a 'solicitor manager' can have difficulty recruiting a solicitor to meet this requirement. A manager being a member of an LLP, a director of a company, a partner in a partnership. Managers are expected to be aware of, and be sure the firm complies with, all statutory and regulatory obligations. If you are a new firm seeking authorisation you will need to make sure at least one of your managers is a solicitor which may be difficult if you've not started your recruitment process yet.
- The application process is a distraction from running a firm and generating fees, so some firms involve a professional adviser from the outset to minimise the time lost.

How does a firm set up/convert to an ABS?

Whether you are a new law firm or an existing practice looking to convert to an ABS, the process is broadly the same. An application needs to be made to the SRA via my.sra.org.uk/ dashboard, usually using the following forms:

- FA1 – Firm authorisation application
- FA2 – Individual approval application – separate forms for each of the COLP, COFA and non-lawyer for a conversion with no other changes, otherwise all managers and owners should also complete a separate form
- FA3 – Entity manager owner application – where relevant. This form is required where a firm wishes to add another organisation as a manager or owner

- FA8 – Financial services notification form – where relevant. This form is required for both new firms intending to provide financial services and existing firms converting to an ABS who already offer financial services
- FA10 – Anti-money laundering authorisation form These forms can all be downloaded from the SRA's website.

Planning ahead for this process is sensible, as a number of documents need to be submitted with the application. These documents include:

- Business plan
- Organisation structure chart
- Business continuity and disaster recovery plan
- Three-year forecasts including profit and loss, balance sheet and cashflow
- Valid PII certificate or offer letter
- A basic disclosure and barring service (DBS) check for each owner and manager
- Certificates of good standing (where applicable)
- Shareholder / Partnership / Members agreement

The DBS checks should not be older than three months old at the time of the application, otherwise this may delay the process. DBS checks are taking the Disclosure and Barring Service up to 8 weeks to process at present.

How long does the process take?

The SRA website states that a decision will be made within three months, but that if there is a suitability issue their decision could take up to 6 months.

Submit the application at least four months ahead of the planned ABS start date to allow time for dealing with any queries the SRA may have, although applications can take as little as one to two months.

How much does it cost?

The SRA's administration fee for processing applications for a recognised body or recognised sole practice is £200.

The fee for a licenced body administration is £2,000 plus £150 for any individual or entity that needs approval.

These costs exclude professional support fees.

Exceptions

An ABS structure is available only for English and Welsh law firms. There are plans for Scottish ABSs, but no timescale yet for this to happen.

ABS set-up top ten

1. Understand the reasons why you want to convert to an ABS.
2. Determine the ideal conversion date, which usually ties in with a year-end.
3. Set aside sufficient time to complete the application forms and additional documents.
4. Obtain agreement from all existing shareholders/directors/partners/members; and for new start-up ABSs, recruit a solicitor manager.
5. Start discussions with the potential new non-lawyer owner/manager
6. Download the necessary forms from the SRA website
7. Delegate tasks to appropriate people and allocate deadlines
8. Request DBS checks at the right time
9. Covering letter referencing all attachments and explaining the background and reasoning
10. Appoint advisors to review the forms before submitting them to the SRA

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INITIAL CONSIDERATIONS FOR LAW FIRM CLOSURE, SALE OR MERGER: CHECKLIST



This is the first part of our published article in Practical Law, the full article can be found at www.practicallaw.com

A checklist highlighting some of the commercial, operational and client management issues for law firm leaders and compliance teams that are marketing and planning for the closure, sale or merger of a Solicitors Regulation Authority (SRA) regulated law firm in England and Wales.

When closing or selling a Solicitors Regulation Authority (SRA) regulated law firm, or merging it into another firm, there are significant compliance requirements that law firm leaders and compliance officers need to consider, alongside the commercial aspects of the transaction.

It is important to plan well ahead to achieve the best result for law firm owners, staff and clients, and to minimise risks for all by identifying the steps that need to be taken to ensure all regulatory obligations are covered. Obtaining guidance and support at an early stage from sector specialist advisers experienced in closing, selling or merging law firms will be invaluable.

This checklist sets out some of the commercial, operational and client management issues that should be considered when planning a sale or merger that will effectively close a law firm. There will be other compliance considerations that the firm leadership will need to take into account.

This checklist does not cover the detailed mechanics of the sale process, or the particular issues relating to closing, selling or merging a potentially insolvent or bankrupt firm. If there is any risk of firm insolvency, professional advice should be sought at an early stage.

The Law Society and SRA have also published guidance on closing down an SRA regulated law firm (see [SRA: Guidance: Closing down your practice](#) and [Law Society: Closing down your practice: regulatory requirements](#)).

Pre-sale commercial considerations

The firm leadership will usually consider financial issues first, as part of considering whether to close completely, or to sell or merge the firm. This will include considering how to maximise the value of the firm and how to minimise its costs and exposure to risk.

Identify valuable key individuals

Although firms may publicly focus on brands (both of the overall firm and sub-brands given to particular products, services or teams), often significant parts of the firm's business and workflow depends on particular individuals. Prospective acquirers (that is, those who may consider buying or merging the firm) will therefore often be concerned about whether these key individuals will remain with the business after acquisition. For this reason, many acquirers will seek to include a contractual term as a condition of the acquisition, binding key individuals to remain with the business for a set period post-completion. Any significant departures during the marketing period, or before completion of any agreed sale or merger, is therefore likely to have an impact on how attractive the firm is as an acquisition and may either reduce the price an acquirer is prepared to pay for the firm or deter acquisition altogether.

The firm should therefore:

- Identify the key individuals who may be significant for these purposes. These may be individuals who:
 - are marketing superstars (sometimes colloquially called rainmakers);
 - have niche or superior technical expertise;
 - hold key client relationships; or
 - command significant internal loyalty.
- Consider how best to address this issue in the firm's particular circumstances and in the light of the firm's estimate of how these individuals are likely to react to the proposed sale or merger.

continued overleaf...

Ascertain sources of instructions

A prospective acquirer will want to understand the main sources of the firm's work, both in terms of practice area and client type, but also the route by which clients come to the firm.

The firm should:

- Analyse its billing data, which will readily show the practice areas and client types that generate the majority of fees.
- Monitor and log the sources of all new enquiries and instructions, and their relative sizes in terms of anticipated costs.
- Consider all sources, including direct referrals (from other firms or affiliated entities), word of mouth, personal contacts, local knowledge, marketing and networking events, advertising, social media, search engines, pay per click and so on.
- Analyse the levels of conversion (that is, how much of the interest or enquiries generated by each source develops into actual fee-paying instructions).
- Prepare to use this data to demonstrate to a potential acquirer how the firm's work is generated and how the most profitable sources can continue post-completion.

Repeat business

Potential acquirers will want to understand the level of repeat business the firm is receiving, and what the contractual position is with the relevant clients, so that it can consider how far the clients are bound to continue instructing the firm after completion of the acquisition.

Repeat work from significant individuals and families is often founded on personal relationships with key individuals within the firm. Some commercial relationships can also hinge on personal connections, irrespective of the contractual position, and any acquirer will therefore be interested in the retention or departure of the individuals involved (see Identify valuable key individuals).

The higher the levels of repeat business (rather than one-off instructions) the firm receives, the higher the multiples that could be applied in any valuation of the firm, and therefore the higher the potential sale price.

The firm should therefore:

- Identify and document its sources of repeat work and the level of annual income generated. Sources of repeat business may include:
 - clients who provide bulk work, for example, commercial developers with a large portfolio of developments providing bulk conveyancing instructions and repeat instructions to other areas like planning and construction;
 - clients who form a relationship with the firm (whether formal or informal) and look to it for all of their legal needs, for example, a university who uses the firm for everything from employment to charity and conveyancing work, or a financial institution where the firm is on their panel of approved legal firms; and

- significant individuals and families who have developed a loyalty to the firm over time. These clients will often have no overarching agreement with the firm, but will instruct the firm repeatedly out of a sense of personal relationship and understanding.

- Ascertain and be prepared to demonstrate the contractual relationship with each source of repeat business, and how that relationship is likely to continue after sale or merger. This may include clients on:

- specific bulk work terms (sometimes referred to as service agreements or bulk retainers), often with one annual overarching set of contract terms;

- other overarching agreements with the firm, which may include subscription-model engagements for ad hoc general advice, in addition to terms for individual matters; or

- the firm's standard engagement terms, but which perhaps benefits from a policy within the firm.

- Consider the significance of any key individuals who maintain relationships with repeat business clients, and the likelihood of their clients continuing to instruct the firm; both whether the individual stays with the firm and if they do not (see Identify valuable key individuals).

- Prepare to demonstrate to potential acquirers that viable repeat business will continue after acquisition.

Unique selling points (USPs)

The firm should:

- Consider whether it has any unique selling points that will make it more attractive to a potential acquirer. Such USPs might include:

- niche areas of legal practice;

- niche knowledge, for example, knowledge of particular issues or concerns in the local area;

- unique client relationships, for example, close relations with a local university, hospital trust, large local commercial enterprise or landed estate; or

- innovative legal services products that the firm has developed and is known for.

- Consider how any USPs can be developed and enhanced, and how they could be evidenced and demonstrated. Doing so may also benefit the firm in practice in the interim, and potentially increase its income as well as attractiveness to an acquirer.

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Contact Andy Poole via andy.poole@armstrongwatson.co.uk if you would like assistance with any of the topics raised in this series of articles.

SRA ACCOUNTS RULES: TOP COMMON BREACHES



We are now over three years since the SRA Accounts Rules changes in November 2019. This means we have a few years data to establish the most common breaches that we see under the new rules.

So what are the most common breaches identified and how can you take steps to improve? Set out below are details of the most common breaches we identify and advice on how to manage these internally.

1. Residual balances

Residual balances still remains the most common breach we see.

Rule 2.5 states: You ensure that client money is returned promptly to the client, or the third party for whom the money is held, as soon as there is no longer any proper reason to hold those funds.

Residual balances should be dealt with 'promptly' and adequate attempts to return the funds should be made. When reviewing residual balances we often see attempts to return funds being made just before the year end that is under review. Unfortunately, adequate attempts is not just the number of attempts but also the timing of those communications.

Example:

A £50.00 residual balance has been held on account since January 2020. There are a number of internal communications on file from accounting to the fee earner and vice versa, however no communication has been made to the client until November 2021.

There is no de-minimis for residual balances so all balances irrespective of the amount need to be dealt with 'promptly'.

The internal procedure we mostly see is the accounts department sending a weekly/monthly email to fee earners to review, unfortunately more often than not this just becomes a routine and little progress is made.

We recommend running weekly reports, with specific tasks set as a result, and ensuring fee earners are aware of the consequences of these residual balances.

2. Office credit balances

Rule 4: Client money must be kept separate from money belonging to the authorised body

There are a number of valid reasons for office credit balances e.g. refunds from third parties and clients paying funds direct into the office account. The funds, however, must be transferred from office to client 'promptly'. Although 'promptly' is subjective from firm to firm, we would recommend that office credit balances do not extend to more than a few days, ideally being transferred from office to client on the same or next working day.

We recommend running weekly reports for office credit balances and investigating and resolving potential issues immediately upon discovery.

3. Payments to charity

Rule 5: Withdrawals from client account

We appreciate it can be tempting to transfer small balances to charity rather than attempting to return sums to clients, due to the administrative time involved. In addition, the cost of sending a cheque etc. can sometimes outweighing the balance itself. As a result of this we often see small residual balances being paid to charity without client authority or any attempts to return their money.

We understand the difficulties of dealing with these balances; nonetheless (as with Rule 2.5) there is no de-minimis level and attempts to return or client authority is therefore required prior to paying such sums to charity, however small the balance.

This can be frustrating for firms but numerous immaterial balances can soon amount to hundreds (sometimes thousands!) of pounds of client money.

We recommend running a monthly residual balance report and identifying small balances that could be cleared swiftly by simply emailing the client to ask them if they would like the money returned to them, potentially offering to pay the sum to charity if they would prefer.

4. Duty to correct breaches upon discovery

Rule 6: Duty to correct breaches upon discovery

A detail we also look at during our review is if breaches noted in our previous year's report have been dealt with. This typically occurs with breaches relating to:

- Suspense ledgers
- Immaterial historical balances
- Residual balances

If specific action needs to be taken with a breach identified, this should be done promptly following receipt of our report. If you have difficulty correcting breaches, we are always happy to discuss and advise our clients further.

5. Suspense ledgers

Rule 8: Client accounting systems and controls
Suspense ledgers are perfectly acceptable and used correctly can be beneficial, however it's important to remember that suspense ledgers should regularly be brought down to Enil and only used on a temporary basis.

If you find that a suspense ledger cannot be brought to Enil, a reconciliation should be performed and any historic unidentified balances should be investigated and cleared.

6. Billing

Rule 4.3: Where you are holding client money and some or all of that money will be used to pay your costs:

- a) you must give a bill of costs, or other written notification of the costs incurred, to the client or the paying party;
- b) this must be done before you transfer any client money from a client account to make the payment; and
- c) any such payment must be for the specific sum identified in the bill of costs, or other written notification of the costs incurred, and covered by the amount held for the particular client or third party.

Another recurring breach we identify is costs for disbursements been transferred without a notification of costs or bill provided to client. A notification of costs can include advance notice in a client care letter, but if adopting this approach it is essential to recognise that the specific sum is identified, and if not then a separate notification of actual costs is required.

We understand that the SRA has identified that this can be time consuming and are currently reviewing this rule, so watch this space for developments!

We'd also like to take this opportunity to remind firms that the SRA are very helpful with any advice, specific and general. These queries can be made on an anonymous basis as they do not ask for your details. They can be contacted through the following means:

Helplines

Professional ethics helpline for solicitors

Call **0370 606 2577** (inside the UK).

The professional ethics helpline service is provided by solicitors experienced in various areas of law. They offer advice on the Standards and Regulations to solicitors, trainee and solicitor apprentices. You can choose to remain anonymous.

Phone opening hours

Monday to Friday: 10.00 - 13.00 and 14.00 -16.00

Web chat opening hours

Monday to Friday: 09.00 -10.00 (closed Wednesday), 13.00 -14.00 and 16.00 -17.00

You can also contact professional ethics by emailing professional.ethics@sra.org.uk

If you would like any support with potential SRA Accounts Rules breaches, or advice on the most appropriate systems and controls please contact Sadie Archibald.

SADIE ARCHIBALD

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AN INTERVIEW WITH...



Andy Poole interviews one of the legal sectors' recognised leaders, Charles Layfield, who operates in a Chairman, Non-Executive Director or equivalent roles.

Andy and Charles explore the importance of effective decision-making and leadership in a dynamic and rapidly changing legal sector.

1. How do you define leadership?

Obviously, there are a wide range of definitions and subjective views on what leadership is, and what it is not. The one phrase I probably use more often than any other is that effective leadership is all about providing positive energy, direction, and focus.

This equates to a sharp focus on strategy and people. Establishing a robust strategy for the business is far more about where you play to win than how you play. By this, I mean it is an essential ingredient of success to invest the time to define and focus on those attractive and growth market segments matched to where the organisation can gain a competitive advantage through its core strengths and credibility, as well as identifying where a market may be at the top, or beyond, the S curve and in decline, thereby making long-term success a challenge, no matter how well you perform.

Once the strategy is in place that's 10% of the job done. The 90% and hard yards is all about having a robust strategic execution plan and supporting internal infrastructure and control framework, which is then delivered and closely monitored and managed.

Equally, at the heart of it, leadership is all about the people, at every level, of the business. No matter how much any business depends on technology or other such capabilities, it's all about getting the right people in the right place and giving them the support, the framework, and freedom to deliver the strategy.

2. What do you mean by effective decision-making?

Everything, good and bad, emanates from the leadership team's capabilities, approach, and cultural style. In the long-term it is impossible for a law firm to be successful, without a high-performing leadership and decision-making body established.

An effective Board is accountable for providing (in equal measure) support and challenge to the day-to-day management team and their decision-making. It's important not to interfere with the typical management activities. Supported by the provision of timely, accurate and high-quality information for Board meetings there must be sufficient, but efficient, time made available to discuss the material issues a law firm is facing. This will ensure there is adequate focus on the long-term risks and opportunities for the business.

The discussion is important but essentially the Board must have a sharp focus on informed decision-making and at pace take the key decisions which will advance the business towards its long-term goals.

3. What are the key factors you feel are currently influencing the legal sector and how can law firms best navigate their way ahead?

Naturally, the legal sector is not one amorphous collection of legal services providers. Understanding the different external dynamics in any one market segment is critical, as is assessing each market segment in as much granularity as is reasonably possible, so that services tailored to the unique needs of those customers.

However, the key issues I believe are affecting most in the legal sector currently are a combination of local and macro environmental factors.

The recent pandemic and the after affects, combined with the persisting high-inflationary environment we are all operating in has brought significant challenges, but also opportunities to many law firms. While there have been casualties as a result, many firms with solid foundations have fared far better than expected and these significant external factors forced them to face into some tough decisions, especially regarding their operating models and costs bases which probably should have been addressed well before the advent of Covid. Nonetheless, it has been a testing time for those having to lead firms through such a unique period.

The cost of capital and inflationary environment is naturally presenting a challenge for those firms that do not have a strong financial footing. It is essential firms have a very clear grasp of their financial status, cash control and forecasting and secure long-term access to capital.

From the dozens of conversations, I have had with leaders of law firms in the last 12 months, it is apparent for many that succession planning and retention and attraction of talent is more competitive and important than ever. Going back to my comments above on the importance of your people, there are not many things more critical than having a defined strong culture and employee proposition, which provides the best opportunity to attract, train, develop and retain your people.

The advent of "new entrants" to the legal sector, whether as legal services providers, providers of lawtech or otherwise, is increasing competition, as is the ongoing regulatory reforms driven by the LSB and frontline regulators. This requires law firms to consider and adapt how they operate in an environment where capabilities and experiences others are bringing to bear, for many, are not experiences and skills they may necessarily have within their leadership team.

4. What value can a good Chairman/Non-Executive Director bring to a law firm?

An accomplished Chairman or NED will provide independent scrutiny, challenge and support of the firm's management team and business performance. Without the shackles of being a direct report to a CEO or another full-time member of the firm, and with the express mandate to challenge the CEO/leadership team, they can create a better, more open, and incisive debate on the key issues.

Sound decision-making is also achieved through ensuring there is sufficient diversity brought to the debate and facing into those tough issues. Relevant sector, or adjacent sector, expertise is often very useful but at the same time bringing a different perspective to the business through external market insights and different, relevant experiences is often an important component. I work hard to combine my 25 years+ in the profession, with the depth of experiences I have had outside of the sector, to bring a broad range of perspectives to a Board and to support the key decision-making processes.

Key is supporting a high standard of accountability across the leadership team to make the right calls in an objective but ethical manner, aligned with the culture of the organisation.

It is highly important that the Chair/NED "fits" with the firm's culture, which will vary greatly from one law firm to another. The Chair/NED must be able to work closely and positively with the management team and other key stakeholders. Equally, it is vital the management team accept the importance of and are open to having an independent person scrutinising their performance.

CHARLES LAYFIELD
CHAIRMAN, NON-EXECUTIVE DIRECTOR

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