

# Legal Sector Briefing

Thursday 3 October 2013

Legal sector update  
Financial stability

1 hour CPD – Authorisation Ref: EKQ/ARWA



# Legal Sector Briefing

Thursday 3 October 2013

4.00pm	-	Arrival
4.15pm	-	Informal briefing
5.15pm	-	Q & A
5.30pm	-	Buffet
6.00pm	-	Close



# Legal sector update

## Financial stability

Andy Poole

Legal Sector Director

Armstrong Watson



# Benchmarks

	2010	2011	2012
Fee income per fee earner			
Profit per equity partner			
Break even point per fee earner			
WIP days			
Debtor days			
Borrowings per equity partner			

Source: LMS Financial Benchmarking Surveys



**Armstrong Watson<sup>®</sup>**  
Accountants & Financial Advisers  
A track record of providing solutions to the legal profession

# Driving cash flow and profitability to ensure financial stability

## Agenda

- SRA risk indicators
- Key performance indicators
- Benchmarks
- Financial analysis, reporting and forecasting
- Key points to improve cash flow and profitability



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# SRA Risk Indicators

Samantha Barrass, 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”



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# SRA Indicators of financial instability

## Key Indicators

- Drawings exceeding profits
- Borrowing exceeding net assets
- Borrowing over a certain level

## Impact Assessment

- RAG rating
  - Red - Two or more indicators
  - Amber – One indicator
  - Green – No indicators
- Impact score



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# SRA Risk Indicators

Samantha Barrass, SRA Executive Director:

“What we are seeing is how well the firm is run, their ability to spot and manage early warning signs, their financial management, their approach to risk taking and their willingness to engage and co-operate with us having a major bearing on whether they succeed or fail”



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession



# SRA Indicators of financial instability

## “Bad behaviours”

- Payments made to partners irrespective of cash in the bank
- All net profits drawn with no reserve pot retained
- Short term borrowings to fund partners' tax
- VAT received used as cash received, resulting in borrowings to fund VAT due to HMRC
- Heavy dependence on high overdraft borrowings
- Partners capital injection is 100% borrowed
- Partners out of touch with office account bank balances
- “Problem, what problem?”



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# SRA Indicators of financial instability

## “Good behaviours”

- 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
- All partners regularly receive full financial information including office account bank balances
- Profitability levels are tested and unprofitable work is dropped



**Armstrong Watson**<sup>®</sup>

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# SRA Risk Indicators

Samantha Barrass, SRA Executive Director:

“What we are seeing is how well the firm is run, their ability to spot and manage early warning signs, their financial management, their approach to risk taking and their willingness to engage and co-operate with us having a major bearing on whether they succeed or fail”



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# Spot and manage early warning signs

"Bad behaviours"	Result	Cause	Driver
Payments made to partners irrespective of cash in the bank			
All net profits drawn with no reserve pot retained			
Short term borrowings to fund partners' tax			
VAT received used as cash received, resulting in borrowings to fund VAT due to HMRC			
Heavy dependence on high overdraft borrowings			
Partners capital injection is 100% borrowed			
Partners out of touch with office account bank balances			
"Problem, what problem?"			



**ArmstrongWatson**<sup>TM</sup>  
*...we're with you.*

# Spot and manage early warning signs

## Key performance indicators

- Average fee income per fee earner by department
- Gross profit percentage by department
- Utilisation percentage by fee earner
- Recovery rates by fee earner
- Debtor days by department
- WIP days by department
- Lock up days by department



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# Benchmarks

Fee income

Chargeable hours per fee earner per annum

	Hours
All firm sizes	1,068
Small	1,115
Large	958

Source: Armstrong Watson benchmarking database



# Benchmarks

## Profitability

Recovered rate per hour

£/Hour

All firm sizes

136

Small

119

Large

151

Source: Armstrong Watson benchmarking database



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# Benchmarks

## Profitability

Net profit percentage

%

All firm sizes

30

Small

29

Large

36

Source: Armstrong Watson benchmarking database



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession



# Benchmarks

## Profitability

Profit per equity partner

€

All firm sizes

91,000

Small

78,000

Large

139,000

Source: Armstrong Watson benchmarking database



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# Impact

## How to increase profitability

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



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# Impact

## How to increase profitability

What would the profit per equity partners be if the recovery rate increases by 10%?

Gearing	2.5
Hours	1,068
Recovered rate/hour	150
Profit margin	30%
Profit per equity partner	



**ArmstrongWatson<sup>TM</sup>**  
*...we're with you.*

# Impact

## How to increase profitability

What would the profit per equity partner be if the hours and recovery rate both increase by 10%?

Gearing	2.5
Hours	1,175
Recovered rate/hour	150
Profit margin	30%
Profit per equity partner	



**ArmstrongWatson<sup>TM</sup>**  
*...we're with you.*

# Impact

## Case study: summary

- Increase any of the factors by 10% and the profit per equity partner will increase by 10%
- Increase all by 10% and profit per equity partner increases by over 40%
- Key = utilisation and recovery



**ArmstrongWatson<sup>TM</sup>**  
*...we're with you.*

# Benchmarks

Cash flow

WIP days

Days

All firm sizes

99

Small

85

Large

124

Source: Armstrong Watson benchmarking database



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# Benchmarks

Cash flow

Debtor days

Days

All firm sizes

68

Small

58

Large

99

Source: Armstrong Watson benchmarking database



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# Impact

## Case study: how to increase your bank balances

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



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession



# 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



**ArmstrongWatson<sup>TM</sup>**  
*...we're with you.*

# Impact

## Case study: summary

- Billing one day earlier reduces your overdraft by  $1/365 \times \text{fee income}$
- Collecting debts one day earlier reduces your overdraft by  $1/365 \times \text{fee income}$
- Key = WIP days and debtor days



**ArmstrongWatson<sup>TM</sup>**  
*...we're with you.*

# Financial analysis, reporting and forecasting

## 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
  - what is important to the firm



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# Financial analysis, reporting and forecasting

## 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



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# Key points to improve cash flow and profitability

- Base on KPIs

## Utilisation

- Time record in all departments – as matters progress
- Time sheets to be submitted by a certain time point
- Set minimum time to be on all timesheets
- Person responsible for checking timesheets have been submitted
- Heads of department to monitor utilisation rates for their department and justify to the partners or make appropriate decisions
- Monitor fee earner fee income multiples of salary



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# Key points to improve cash flow and profitability

- Base on KPIs

## Recovery

- Record all time
- Monthly review by fee earner of recoverable WIP
- Write off irrecoverable WIP monthly
- Bill promptly on completion
- Monitor recoveries on each bill or on a monthly basis by fee earner
- Partner approval for all under-recoveries of more than 10%
- Partner approval for any direct WIP write-offs
- Stop acting in unprofitable work types
- Stop acting for unprofitable clients
- Use of cost draftsmen
- Abort fees



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# Key points to improve cash flow and profitability

- Base on KPIs

## WIP days

- Time record in all departments – as matters progress
- Weekly review by fee earner of recoverable WIP
- Write off irrecoverable WIP monthly
- Bill on account
- Bill promptly on completion
- Ensure all associated WIP is written off when a bill is raised
- Concentrate in two areas
  - Log jam
  - Easy wins
- Accounts department to review aged WIP prints



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# Key points to improve cash flow and profitability

- Base on KPIs

## Debtor days

- Payments on account
- Bill on account
- Bill promptly on completion
- Automatic transfers from the client account?
- Daily reviews for amounts to transfer from the client account
- Transfers for disbursements
- Unpaid professional disbursements
- Don't wait for client approval!
- Empowered credit control
- Credit control to review aged debtors
- Stop work!



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession



# Questions

- What questions do you have?



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# Summary

## Key points

- Small changes can have a big difference
- Four factors to concentrate on:
  - Utilisation
  - Recovery
  - WIP days
  - Debtor days
- Use KPIs to drive the firm in the right direction



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

# Disclaimer

This presentation and supporting documentation has been prepared in general terms and therefore cannot be relied upon to cover specific situations; application of the principles set out will depend upon the particular circumstances involved and we recommend that you obtain professional advice before acting or refraining from acting on any of the contents of this presentation and/or supporting documentation. Armstrong Watson would be pleased to advise on how to apply the principles set out here to your specific circumstances. Neither Armstrong Watson nor the presenters accept a duty of care or liability for any loss occasioned to any person acting or refraining from acting as a result of this presentation and supporting documentation.



**Armstrong Watson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession

**Andy Poole**  
**Legal Sector Director**  
**Armstrong Watson**

Carlisle Office

Fairview House, Victoria Place, Carlisle CA1 1HP

T: 01228 690200

F: 01228 690201

M: 07828 857830

Twitter: @AW\_AndyPoole

E: andy.poole@armstrongwatson.co.uk

[www.armstrongwatson.co.uk/legalsector](http://www.armstrongwatson.co.uk/legalsector)



**ArmstrongWatson<sup>TM</sup>**  
*...we're with you.*