COWGILL HOLLOWAY

Issue 2

Putting Business Into Practice

MANAGING IN A DOWNTURN:

The fundamental priorities to shaping your business in challenging times.

In our second edition of Putting Business into Practice we look at the ways in which law firms should be shaping their business to deal with the challenges of the current economic climate.

Many law firms achieved record levels of profits and fee income growth during 2008. Law firms had at this point seen four successive years of such annual increases. Unfortunately this was not to last. The latter part of 2008 saw the credit crunch start to bite. 2009 sees the UK in recession.

Given these challenges it is likely to prove difficult for law firms to sustain the levels of profit and fee income seen over recent years. Despite opportunities in litigation, insolvency and employment the short-term future looks uncertain for some firms. In the current downturn therefore it is essential that law firms focus on the fundamentals of good business practice and ensure that adequate financial controls are present within the business.

In this issue we take a look at some of the important areas where taking action now could make a big difference to the ability of the law firm to maintain its current and future financial stability.

Managing cash flow and working capital

The challenges faced in the economic downturn mean that more than ever cash is king, and that it is vital to have a robust cash management system in place. Preparing a detailed cash flow forecast for at least the next three to six months will allow the firm to predict and plan for peak cash requirements in months where VAT, tax and capital outlay will occur. This will also highlight head room against the firm's current borrowing facilities and provide advanced notice of cashflow spikes where assistance may be required.

Managing lock-up and controlling of work in progress and debtor levels has never been more important. Benchmarking information can be extremely useful in determining whether a firm is effectively managing this part of the business and targets should be set to measure KPI's and cash collection to ensure the business has sufficient cash resource.

Firms will no doubt consider improving their billing processes. Payments on account and interim billing will become a more effective way of reducing exposure. Credit agencies can be useful to a point, although it is likely that any external assessment is based on historical information, which under the current climate may not be particularly relevant. The deterioration in payment patterns is an indicator that a client is less able to discharge his fees and therefore a full examination of the client's affairs should take place before any significant credit is extended.

Protecting profitability

Managing and protecting profitability is the main item on any managing partner's agenda at the moment. Law firms should be monitoring profitability on a departmental basis and every departmental head should be aware of their historical and projected profitability to enable the required level of performance to be achieved. The use of forecasts and actual management information to assess performance against forecast is vital to identify potential shortcomings which are inevitable in certain departments, property and commercial being the most likely departments being threatened at the moment. The use of contribution accounting will enable the managing partner to control costs on a departmental basis and action can therefore be taken if warning signs arise.

In order to control fixed overhead it is likely that further saving could be achieved by outsourcing certain aspects of the business overhead. Increasingly, areas such as finance, HR and IT are all potentially suitable candidates allowing for a cost reduction.

Improving the cash position with tax strategies

It is possible to preserve cash and to improve earnings by carefully reviewing the firm's tax strategy. Law firms should consider the following areas:

- Preserve vital cash in the business by making a claim to reduce tax payments on account where the firm's management accounts show declining profit levels compared to last year.
- Consider extending the year-end accounting date where profits are decreasing. Careful planning in this area can accelerate tax relief.
- File VAT returns on-line and pay by Direct Debit to defer payment by 10 days after the normal due date.
- Make sure that VAT liabilities are reduced by making claims for VAT bad debt relief once debts are over six months old.
- Where partners own the business premises ensure that appropriate claims are made for embedded capital allowances relating to fixtures and equipment. Such claims will reduce tax liabilities.
- Finally where the firm is struggling in the current climate and needs time in which to pay its tax, National Insurance or VAT owed to HMRC, get in touch with the Business Payment Support Service. HMRC has set up this service to facilitate instalment arrangements. Whilst interest will be charged on late payment of tax, there will be no surcharges so long as an approach is made to HMRC before the surcharge would have fallen due.

Reliable management information is key

Statutory accounts are about compliance with reporting profitability from a taxation and legal perspective and are historical by their nature. Management accounts measure where the firm is creating its value and profitability, and need to be prepared monthly and delivered promptly thereafter to the partners and managers of the firm.

Budgets should be drawn up at the start of each financial year by departmental or practice area, showing forecast fees less costs directly attributable to that department (including partners' notional salaries) resulting in forecast departmental contribution. Concentrate on areas which can be controlled and influenced in order to measure contribution to overhead recovery and profit rather than the "bottom line".
This allows comparison of running one department with another and the contribution that department makes after costs directly attributable to it and partners' notional salaries. In this way departmental profitability can be measured on a "like for like" basis across the firm and evaluated against benchmarked information to improve profitability.

The management accounts should show actual performance compared to budget for each department together with the KPIs that best target better financial performance for that department. The reports should clearly highlight variances from budget thus pointing to areas to be acted upon to get performance back on track where needed.

It is worth considering maintaining a rolling 12-month forecast as well as the normal 12-month budget. The two budgets are drawn up simultaneously and the rolling forecast is updated at the end of each quarter to project current trends further into the future. This can help the firm to anticipate events earlier and adjust strategy sooner than if concentration was focused only on the year-end.

How we can help

Navigating through turbulent times is never easy. The instinctive reaction is to retreat and use defence mechanisms until things get better. But retreating is not always the right decision and making constructive changes to cope with economic challenges can make businesses stronger in the long term. To find out more on how **Cowgill Holloway** can help you through these challenging times contact **Sue Gallagher** on **01204 414256** or email **sue.gallagher@cowgills.co.uk**

COWGILL HOLLOWAY

Bolton Office:
Cowgill Holloway LLP
Chartered Accountants
Regency House
45-51 Chorley New Road
Bolton, BL1 4QR
Tel: 01204 41 42 43
Fax: 01204 41 42 44

Manchester Office:
Cowgill Holloway LLP
Chartered Accountants
49 Peter Street
Manchester
M2 3NG
Tel: 0161 827 1200
Fax: 0161 827 1201