MHA Professional Practices Newsletter

Autumn 2014

Welcome to the Autumn edition of our Professional Practices newsletter. This edition will focus on risk with articles on:

- Financial stability as a risk factor
- Cash flow management: Billing and VAT

It's a Risky Business

By Martin Bugg, MHA member firm Larking Gowen

With the Solicitors Regulation Authority ("SRA") operating as an outcomes-focused risk based regulator with the view to achieving the goal to deliver the right outcomes for the public, are you addressing all the key concerns for your business? Financial stability is one key area the SRA are investing time looking into.

The SRA has published its spring 2014 risk outlook. Within the document the financial difficulty and dishonest misuse of client money or assets is discussed, with the SRA highlighting that they are now receiving more reports of misuse of client money both from external sources and through their own supervisors uncovering issues on visits to firms.

This follows two solicitors recently being struck off for misusing clients' funds. The first misused more than £400,000 of clients monies to prop up her ailing firm. Payments ranged from settling of the business council tax, to payments to the solicitor's personal account.

The second failed to pay funds he'd been given to settle a dispute out of court, and also converted £3.2 million of client funds into a banker's draft.

At the recent ICAEW Solicitors Special Interest Group conference, which the Larking Gowen legal team attended, Andrew Garbutt, Director of Risk for the SRA, gave an overview of the position.

Andrew explained that the SRA have recently undertaken a targeted call for financial data from 2,000 firms where the SRA had identified an enhanced risk. Virtually all firms responded, with half the firms surveyed not scoring on the risk matrix, whilst the other half showed increasing signs of financial failure. This resulted in varying actions from a brief telephone call with the COFA, to visits and as a last resort, intervention.

As a result varying factors were looked at to assess financial difficulties:

- Inability to measure or control financial performance.
- Excessive use of borrowing and debt.
- Excessive partner drawings in relation to profit and income.
- Over dominant senior partners with lack of transparency of financial data.
- Inappropriate use of the client account.
- Poor processes for collecting on bills for completed work.

- Inadequate planning and due diligence for diversification of the legal practice or acquisitions of other firms.
- Narrow focus on a single type of legal work.

Risk is a key factor in the ever changing legal market. The published SRA resources are a good start to understand the view and which areas your legal firm should start to focus on.

Overall the SRA believes the risk of financial difficulty remains high in firms across the legal services market. This is a risk that the SRA see can be controlled by firms, through effective business and financial management processes, as well as by dealing openly with their regulator.

Our specialist legal team can provide guidance in respect of risk and financial difficulties. Contact us if you need any help and we would be happy to assist.

Cash flow Management: Billing and VAT

By Karen Hain, MHA member firm Moore & Smalley

Compliance

If you are the COFA for your firm you may wish to consider including 'billing' in your staff handbook to ensure all employees and managers comply with your firm's policy. This is important as part of your firms monitoring of financial stability and compliance with SRA regulations.

VAT schemes

In contrast to the standard VAT accounting scheme where you pay VAT on bills issued, and reclaim VAT on supplier invoices received, there is an alternative scheme designed to deal with cash flow issues, especially if your clients are slow payers.

The Cash Accounting VAT scheme

This scheme can currently be used if your firm's estimated VAT taxable turnover (net of VAT) is less than £1.35 million per year. Although this turnover limit is subject to change by HMRC, using the scheme allows you to declare the VAT on your fees only when your clients pay you; and reclaim VAT on your expenses/ purchases only when you have paid your suppliers.

The main advantage of this scheme is that you do not have to pay VAT to HMRC until you have received payment from your clients and therefore, if your client never pays you, you will never have to pay the VAT on that debt as long as your firm continues to use the Cash Accounting Scheme.

If you currently use the standard VAT scheme but are eligible to join the Cash Accounting scheme you do not need to apply or advise HMRC. You can start using the scheme at the beginning of your next VAT period as long as you continue to record your accounts in the same way, but keeping track of bills unpaid when preparing your quarterly VAT returns.

Unfortunately, if your firm's VAT taxable turnover is more than £1.35 million per year you cannot take advantage of the Cash Accounting scheme, however there are procedures you could implement to aid cash flow, such as:

Applications for payment

Applications for payment are written requests for payment of services rendered. Your client would therefore receive your request for payment before they settle your fees. Once your client has paid, then a VAT invoice can be issued, at which date the VAT is payable to HMRC.

This is a good idea in principle, however if you were to implement this procedure, you would have to take the same approach with all your clients across all departments. There is also an administrative burden involved because you are issuing and recording two sets of fee notes.

Bad debts

VAT on bills which remain unpaid may be reclaimed from HMRC if they are more than six months old. Unpaid bills should be written off in your accounts specifically as 'bad' or 'irrecoverable' before such a claim is made. Any claims for VAT on bad debts should be included within your purchases (Box 4) of your VAT return.

Reviewing your office balances at month end and writing off any bad debts is far easier administratively but only aids cash flow long term whilst the other options noted above could help with more current cash flow issues.

Sharing key management information

I would highly recommend that your firm prepares a monthly cash flow statement, tailored to meet the requirements of your firm. This should be reviewed regularly alongside key management information to ensure cash is not being spent in unprofitable areas. A good behaviour would be to provide all partners of your firm with regular financial updates and include them all in decision making processes, not just senior management.

The research conducted by the SRA, 'Steering the course' indicated that there were a number of case files where senior partners failed to share the true financial position of the firm with other partners and those in other managerial positions so to be prudent I would ask myself the question, 'Would I know if my firm was in financial difficulty?' If the answer is no, now really is the time to do something about it, before it's too late…

Future Activities

Our next newsletter is due for release later this year

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