

Legal Focus

DRIVING LIFELONG PROSPERITY

Summer 2016

SPOTLIGHT ON EFFICIENCY

Welcome...

to the Summer edition of Legal Focus. In this edition, we consider some 'easy win' areas that law firms should be looking at in order to improve efficiency, we look ahead and give you our predictions for the next 12 months, and give an update on some recent regulatory changes that will affect many of you.

We hope you will find it interesting, as well as useful.

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HAZLEWOODS

DRIVING LIFELONG PROSPERITY

Auto-enrolment – three years on

We are now at the halfway stage of auto-enrolment. Having initially started in 2012, with the largest employers being required to put a qualifying workplace pension scheme in place for their employees, the new rules are now beginning to impact on the UK's smaller employers, which includes many legal practices.

Over the last couple of years, we have helped many legal practices to meet their auto-enrolment obligations. We have found the general awareness of the new rules and employer responsibilities to be very good. Whilst auto-enrolment can place new obligations and additional financial costs on employers, most appear to understand why this has come about and have been quite accepting of their new obligations.

So far then, auto-enrolment appears to have been a success amongst employers and employees alike. Over 57,000 employers are now staged for auto-enrolment and around 5.5 million employees have been enrolled into a workplace pension. Disciplinary action from the Pensions Regulator for employers not fulfilling their duties has been low, and a recent survey conducted by the Department of Work and Pensions found that, of all those employees enrolled in 2013 and 2014, only 10% opted out.

Having said that, the next few years have the potential to be the most testing for auto-enrolment. Despite being halfway through the auto-enrolment time frame, only 3% of the total amount of employers expected to stage for auto-enrolment have done so and there are still 1.7 million employers yet to stage, as well as around 4.5 million employees yet to be placed into a workplace pension scheme.

The new rules are now affecting the UK's smallest employers, and they will now also be expected to offer a workplace pension scheme to their employees.

Three years in, and auto-enrolment appears to have been relatively straightforward so far, but there will still be plenty to think about, especially for some of the smaller practices who may not have given the matter their full attention as yet.

If you would like to speak to us regarding auto-enrolment in your practice, we would be more than happy to help.



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The power of simplicity, and efficient working

We have spent lots of time with quite a number of practices over the last year or so working together on improving operational efficiency. The results are amazing, and often mostly as a result of taking 'easy wins' as opposed to doing anything complicated.

A 10% bottom line improvement seems to be realistic for many practices, over perhaps a two year period.

We have put together a list of some examples to show how uncomplicated it can be.

1. Pitching for work – most practices are busy now, and pitching can lose some of the attention it deserves. Try involving two people when both specifying and costing all jobs over say £2,000, and challenge each other about how to provide the best thought through specification, the most appropriate people to do the work, and the most efficient way of going about it. Also, challenge the proposed fee with each other before it goes out to the client, and speak to the client too about price expectations – it is definitely not all about being seen to be the cheapest.
2. Charge rates – whatever the size of your practice, review your charging matrix. Clearly, more complicated work should be priced more highly, but it is surprising how often rates are set per individual fee earner, as opposed to certain matter types carrying a premium rate.

3. Get the basics of charging time right:
 - a) one set of policy expectations for everyone, so you get consistency;
 - b) enforce the need for timesheets to be completed daily, adopt a consistent approach and make sure they are completed by everyone (including partners);
 - c) spend time with all fee earners so they understand how to manage their unbilled work in progress levels;
 - d) remove any whiffs of policies allowing fee earners to merely charge time up to what they think the client will pay and 'lose' the rest.

4. Make sure all fee earners know what is expected of them in terms of time charged, fees and recoverability. If you have a live performance reporting function within your practice management system, open it up to all fee earners – transparency is so helpful.
5. Encourage staff suggestions about 'fix its' for systems type improvements they would like to see, and action as many as you can.
6. Actively help all staff to challenge their own operational efficiency, delegation and training skills.
7. Review how you go about tasks like money laundering checks, engagement letters, billing etc., and challenge yourselves until you feel that the time spent on each is minimised, without becoming overly mechanical in the eyes of clients.
8. Spend time listening to operational frustrations, and acting.

9. Engage with younger staff members with regard to IT matters – their views are often really valuable.
10. Give voice recognition software a try if you haven't done so recently.
11. Spend quality time together as operational teams so you really know each other. Character and behavioural assessment testing can be fun, and really worthwhile.

We are always available to work with any practice, and will be confident of helping you to see real results – without complication.



Predictions for 2016 and beyond

As we are approaching the mid point of the year, we thought that we would set out our predictions (both good and bad) for the next 12 months. The majority of these are based on nothing more than gut feeling, so please do not hold us to them!

SRA ACCOUNTS RULES

1. There will be at least one consultation on the Accounts Rules during 2016. Whilst the Solicitors Regulation Authority (SRA) will be prepared to revisit items such as the 14 day rule (and hopefully remove it completely), we predict that the requirements around client account reconciliations will not change significantly.
2. The new Accounts Rules (now planned for Spring 2017) will be more outcomes-focused. Expect much less detail, with more freedom to come up with your own internal policies and procedures on how best to deal with client money. The changes to the interest rules a few years ago will give you an idea of where we think we are heading.
3. Practices will need to revisit their interest policies, either because Base Rates have increased or (more likely) because they have not. In our experience, most practices are still using a £20 de minimis limit when deciding whether to pay interest or not, and it is perhaps time for an increase.
4. More guidance to come from the SRA on the role of the Reporting Accountant. Those of you that attended the Institute of Legal Finance and Management Annual Conference in November last year will have heard Andy Harris from our team discuss that the guidance currently issued is a good start, but more is needed to ensure consistency of auditing and reporting between different firms of accountants.
5. Fewer Accountant's Reports will be qualified under the new reporting regime. Where reports are qualified, the SRA will take them more seriously than before, as it will mean that client money is potentially at risk. It is more likely that the SRA will want to visit following a qualified report.

SRA

1. The SRA Handbook is going to be reviewed, with a view to making it shorter and less prescriptive, although we do not expect any significant impact on the levels of compliance required for the majority of practices, at least in the short term.
2. There will be less focus on financial stability. Many practices will not have heard from their Relationship Managers at the SRA for a while, and we suspect that contact will reduce even further. Whether that is the correct approach is another matter, as history shows us that more businesses fail coming out of a recession than during it.
3. There will be greater focus on the threat of cybercrime. The SRA currently has a cybercrime section on its website, under Hot Topics, but we think that more will need to be done to help practices avoid being scammed.
4. Succession will continue to be a huge issue for many practices. Many younger solicitors are keen to maintain a work-life balance, and are more hesitant about moving up to partner level. As a result, partners approaching retirement are finding it increasingly difficult to find successors within their own practices. This could lead to:
 - a. More consolidation of existing practices. We have seen a lot of this in our own client base here at Hazlewoods, and we expect it to continue.
 - b. More new practice start-ups. Although consolidations are up, so is the number of new practices. Over the last few months we have helped several new practice start-ups, including one Alternative Business Structure (ABS), and have been contacted by several solicitors considering setting up on their own.

5. The number of ABSs will continue to rise, although mainly to allow key individuals in the practice or spouses of existing owners to become owners. We are not convinced that we are going to see a rush of further private equity investment in the legal sector.
6. SRA turnaround times will continue to improve. To give them credit, the SRA seems to have worked really hard at improving the way it engages with consumers and the public. We recently helped a new practice start-up to obtain SRA approval in under three weeks, which was fantastic.

PRACTICE ACCOUNTS / FINANCES

1. A new accounting standard – Financial Reporting Standard 102 (FRS102) – is already impacting on larger LLPs and limited companies this year, and will affect everyone else next year. The main areas where we may see significant differences between existing Generally Accepted Accounting Practice (GAAP) and FRS 102 include work in progress (WIP) valuations for certain types of contingent work (more on this later in this Focus), the amortisation of goodwill, holiday pay accruals and the value of members' / directors' loans. Practices will need to review their members' agreements, shareholders' agreements and internal holiday procedures to assess and mitigate any potential impact.
2. Cashflow will become increasingly challenging for many practices. Lots of practices are seeing increasing levels of WIP and debtors, as work flow continues to improve, but clients are taking longer to pay. This, combined with large tax bills on 2014 and 2015 profits, is putting pressure on already tight office bank balances.

CHANGES TO SMALL COMPANY AND AUDIT THRESHOLDS

Cast your mind back a few years and there was something of an anomaly between the financial thresholds below which a company was deemed to be 'small' in accordance with the Companies Act, and the thresholds which determined whether it required an audit or not. This sometimes resulted in 'small company' accounts being filed at Companies House which included an audit report, but were in an abbreviated format that gave no, or at least very little, financial information to the public.

This was rectified a few years ago when the audit thresholds and small company reporting criteria were aligned, and (as we had all been expecting for at least the last year) those thresholds have now been increased.

Note that all of this applies to both limited companies and LLPs, even though most legislation mentions just companies.

So, for companies with accounting periods beginning on or after 1 January 2016, the company is classed as small (and therefore exempt from the need for a statutory accounts audit) if it meets two out of three of the following criteria:

- Turnover – less than £10.2m for the accounting year
- Total assets – less than £5.1m (at the balance sheet date)
- Number of employees – fewer than 50 (on average, in the year)

This is quite a jump up from the previous thresholds for turnover and total assets of £6.5m and £3.26m respectively. There has been no change to the employee limit.

If a company falls below the criteria in its current accounting period, and was also classed as small in the previous accounting period (using the new thresholds) then it can claim exemptions in the current period. That is, a company does not need to look back and apply the previous lower thresholds to prior periods when determining whether it is small.

It is also possible for a company to exceed the thresholds in the current accounting period, but still be classed as small if it would have been small under the new thresholds for the previous two accounting periods.

If a company is exempt from statutory audit, it can choose whether to have:

- a. an Assurance Report; or
- b. an Accountant's Report.

In simple terms, the latter is a report based on no audit type work being carried out, and the former is designed to be a halfway house between full audit and no audit.

This is a basic overview of the new requirements and there are important exceptions that apply to special circumstances, largely away from the legal sector, such as members of a group or charities that are required to follow separate audit thresholds. Also, the members of a company may still request that an audit is carried out even if it is technically exempt, or the Company Articles themselves may still impose the requirement.

Any structural changes within a practice, for example conversion from partnership to a limited company, can also complicate things. Please let us know if you would like any assistance with checking what your practice's choices/obligations are.

BANKS / INSURERS

1. Owners of practices with unrated professional indemnity insurance providers are more likely to be asked to provide personal guarantees on bank borrowings, as banks become increasingly concerned about the amounts of cash tied up in WIP and debtors, and the potential impact of a cybercrime attack.
2. The SRA will remove the need for practices that are looking to switch regulators from the SRA to obtain run-off PI cover. This might open the door for some practices to look elsewhere.
3. Finally, professional indemnity insurers will review their standard terms and conditions relating to cybercrime. We would not be surprised to see a change to terms, requiring additional levels of cover to be taken out to insure against a potential attack.

As we said at the start, most of these are purely guesswork, so it will be interesting to revisit them at the end of the year.

A version of this article appeared in the January / February 2016 edition of the ILFM's Legal Abacus magazine.



Financial Reporting Standard 102 and income recognition - update

Our previous Legal Focus included an article on FRS102, the new accounting standard introduced to replace all previous accounting standards. In it, we set out the areas where we believed that there were likely to be significant differences between existing UK GAAP (Generally Accepted Accounting Practice) and the new standard.

At the time, we were concerned that FRS102 might require practices to recognise income from contingent work earlier than under the previous standards, which were technically known as UITF40 and FRS5(g). These permit all types of contingent work in progress to be excluded from financial statements until such point as the contingent event occurs.

Over the past few months we have looked into this much more closely. We have also shared views with leading authorities in the UK Accounting Bodies, including the Institute of Chartered Accountants and the Financial Reporting Council.

Without reproducing all of the detail here, our view is that FRS102 is unlikely to result in any significant changes to the accounting treatment of contingent work in progress for most practices. i.e. there should not be any large uplift in the book value of work in progress when FRS102 becomes effective. Where there may need to be a change is in situations where practices deal with straightforward claims of the same type on a volume basis, and feel that they could not defend a contention that the outcome of them cannot be predicted with a strong degree of reliability. In this sort of situation, expected income may need to be recognised in accounts before the cases reach the point where the individual contingency has passed. We can easily advise on all of this.

And finally...

We are feeling a little pensive about insurance cover relating to cybercrime, as quite a number of practices we have asked have not been sure of the precise terms/limits of their cover. Please do make sure that you know your cover terms, and add this to your checklist of items to discuss with your broker at the next renewal, in case any action needs to be taken.

We are planning our own seminar on cybercrime this September, which will be different in format to others on offer. We will have a panel of cybercrime experts, consisting of an IT person, an insurer and a banker, to provide a forum where attendees can ask practical questions and expect practical answers.

WATCH THIS SPACE...



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