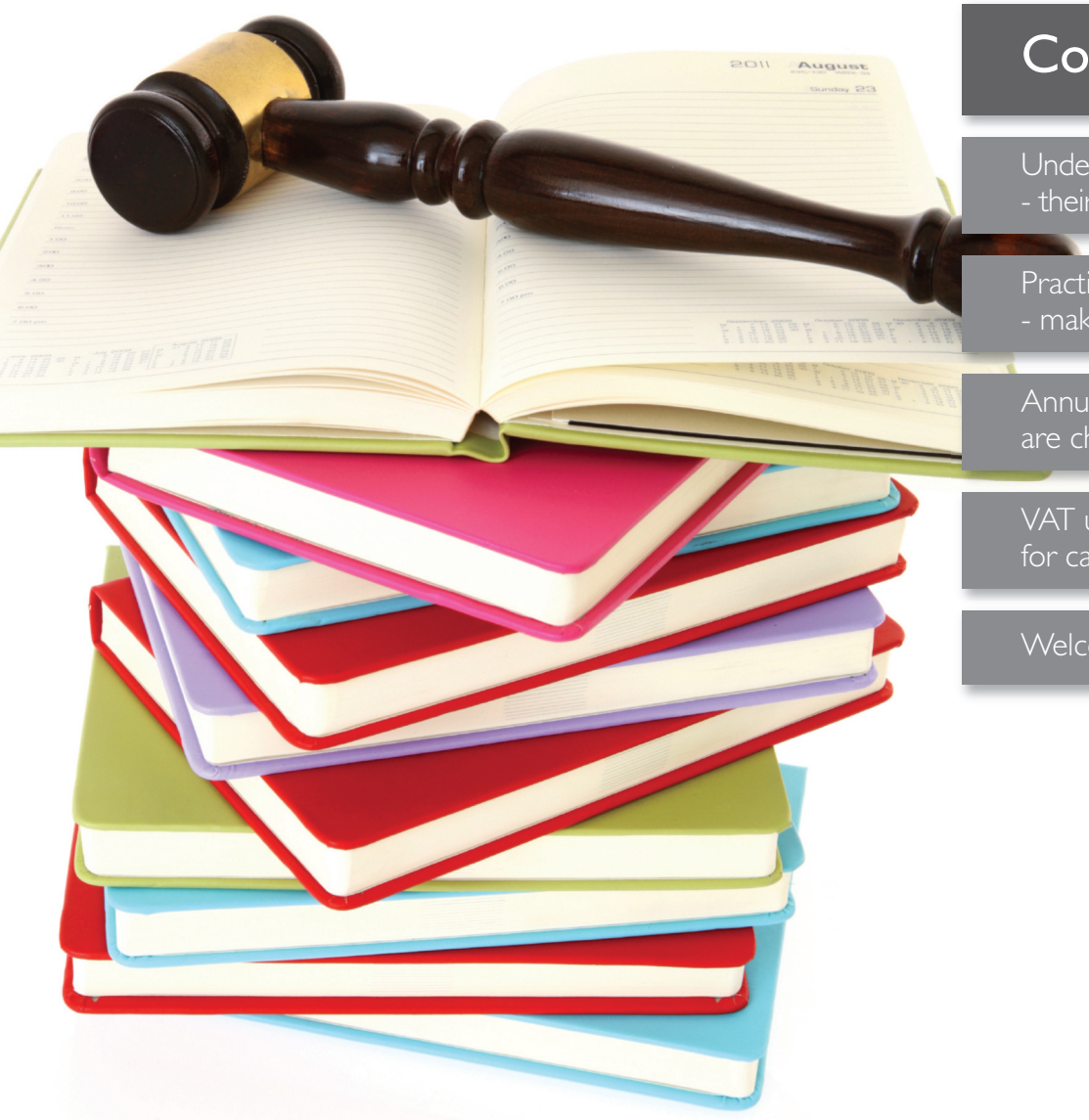
Spring 2012

Legal Focus

Guiding you to lifelong prosperity



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HAZLEWOODS

DRIVING LIFELONG PROSPERITY

Understanding the COFA - their role in practice

Following the introduction of the new SRA Code of Conduct in October 2011, practices should now be turning their attention to the requirement to nominate a Compliance Officer for Finance and Administration (COFA). For existing practices this nomination needs to be done by 31 March 2012 (new practices must have one nominated by 28 February) and the lucky individual must be authorised by the SRA by 31 October 2012.

Role of the COFA:

Before a practice decides who to nominate, they should really have a full understanding of what the role of the COFA is and the skills required to fill the position.

We will not go into too much detail here – the new SRA handbook gives a full list of the requirements (you can find this at: www.sra.org.uk/handbook/) - but we will look at the key features of the COFA role.

At the highest level, the handbook assigns two key responsibilities to the COFA:

- To ensure compliance with the SRA Accounts Rules (the new name for the Solicitors' Accounts Rules);
- To record all failures to comply with the Accounts Rules and to report any such failures to the SRA as soon as reasonably practicable.

On the second point, the guidance goes on to explain that, in the case of non-material breaches, the practice will still be deemed compliant if they are reported as part of something called the Information Report (more on this later).

To support these basic principles, the SRA expects that the COFA will be responsible for overseeing the systems that ensure compliance, and the SRA has suggested a number of controls that a practice should implement to meet the requirements. The suggested controls take something of a basic 'common sense' approach, and we would expect that most of these should already be in place in most well-managed practices.

Some of the suggested controls include:

- Ensuring that only appropriate people authorise payments from the client account.
- Appropriate checks on new staff or contractors and systems to support development and training of staff.
- Ensuring regulatory deadlines are met (including submission of the Accountant's Report, arranging PI cover, practising certificate renewals, etc).
- Regular file reviews.

So, all fairly standard controls, but now all put under the responsibility of one person (whereas previously this would have been the implied responsibility of all principals and managers in a practice).

This list is not exhaustive and, in addition to the SRA handbook, there is further guidance in the Compliance Officers Practice Note that was issued by the Law Society on 8 September 2011. You can find this at: www.lawsociety.org.uk/productsandservices/practicenotes/complianceofficers.page

Our thoughts:

It has become fairly common for the SRA to issue guidance or set requirements that are vague and open to interpretation. This is no exception, so here are our thoughts on the key areas.

Who can be a COFA?

The SRA's guidance states that anybody can be a COFA (that is, they do not need to be a lawyer), as long as they are an employee or manager of a practice, have consented to the role, have sufficient experience and seniority, and are approved by the SRA.

The SRA does not give any definition as to what sufficient seniority and experience mean, but there is a clear requirement that the role is not simply assigned to whoever has the most spare time to fill the position.

To put this in context, the role of the COFA includes a responsibility to report to the SRA when the practice is in serious financial difficulties. This is obviously open to interpretation and could be quite an emotive subject. It is therefore crucial that the COFA has sufficient depth of knowledge to be able to form a reasonable judgement as to whether such a report is necessary or not. You would need to consider the more senior members of the finance team, such as an experienced financial controller or finance director, as individuals with the necessary depth of experience. Practices should not automatically look to the head cashier or practice manager unless they have a detailed knowledge of financial matters or have sufficient knowledge of the practice's financial operation. Too little knowledge or confidence in this area might lead to unnecessary reports being made to the SRA at the first signs of cash flow difficulties or reports not being made at all when they might be necessary. To put it another way, the COFA should always be in full possession of the facts.

The COFA should be comfortable with the requirements of the role and normally the individual would be undertaking these requirements as part of their everyday role in the practice. The role should be a natural extension to their job, rather than a completely new responsibility, albeit that it is a role that brings a greater exposure to the risks associated with non compliance.

The position of the COFA carries personal responsibilities, which may mean that employees who are asked to take it on put in a request for an indemnity from the practice.

What is material?

The COFA must report all material breaches of compliance to the SRA, but what can you classify as immaterial and what should you be reporting? Get this wrong and practices will end up flooding the SRA with trivial reports or, even worse, the COFA will not be fulfilling the requirements of their role and will put themselves at risk of censure.

The Law Society Practice Note does give some general guidance, but our thoughts are that if you can answer yes to the following, we would normally class the breach as trivial:

- Was the breach an innocent mistake?
- Was the breach an isolated incident?
- Was it discovered promptly and corrected without delay?
- Was the error for a 'trivial' amount?
- Was there no loss to the client?

The COFA should consider whether any breach identified is as a result of an ongoing systems weakness and is part of a larger series of breaches. If this is the case, the breach would normally be considered reportable.

We would recommend that in any report you make to the SRA you also advise how the systems have been (or will be) improved to prevent further breaches. Clearly, mistakes are made, but it is important that practices demonstrate a clear willingness to rectify them.

Keeping records:

COFAs are required to keep a record of all breaches (material or not) in compliance, and the Law Society recommends that this should be structured in such a way that patterns of breaches can be identified (as presumably this will indicate system weaknesses).

In a smaller practice, a simple, centrally maintained file of breaches (including details of the breach, date, amounts involved and what has been done about it) should suffice.

In larger practices with more complex systems, then there is probably not a great deal more required than a simple Excel spreadsheet, which can be sorted by department, rule breach, etc.

Other considerations:

For smaller practices (such as sole practitioners or firms with few staff and little segregation of

duties), the role of the COFA can be fulfilled by one person as long as the basic principles are followed. The SRA does make an interesting point on this, in that the systems and controls in place in a small practice to ensure compliance should be proportionate. That is, practices with a straightforward operational structure should aim for straightforward controls. Where possible, avoid overly complex systems as this increases the risk of failure. In short, it is not necessary to implement 'all singing, all dancing' systems when simple procedures give the same result.

We would be happy to advise on any of this if you need further guidance.

Don't forget about the COLP

As you are all aware, there is also a second compliance position to fill, that of the Compliance Officer for Legal Practices (COLP). Their role is much broader than that of the COFA, concerning ongoing compliance with the Legal Services Act, Solicitors Act (among other things) and the general conditions of a business's authorisation to practice.

In the interest of space (and reader patience!) we have not covered this aspect of the new requirements, but full guidance can be found at: www.lawsociety.org.uk/productsandservices/practicenotes/complianceofficers.page

Summary:

As with much of the new Outcomes Focused Regulation, the SRA is putting the onus on you to determine whether your present arrangements comply with the new regulations or not. We would suggest that this is taken as an opportunity to critically review your current systems - change what needs to be changed and leave what works effectively. In the long run, it may well be better having one point of responsibility rather than numerous undefined roles, but only if your chosen COFA is up to the job.

Practice Strategy - making mergers work

Over the past twelve months or so, as more and more practices have begun to see some signs of recovery/stability, we have seen a much greater interest in the idea of merging with other like-minded practices, and have been advisors in many more mergers that have made it across the finish line.

As everyone reading this will appreciate, in many cases, part of the desire to merge has been to grow the existing practice. However, many need to find a short term exit strategy (and one that avoids very costly run-off insurance).

Whatever the reason for wanting to merge, there are some important steps to consider to ensure that the end result is the one that all sides are hoping for.

Take a look at yourselves first

Before you can properly contemplate any form of amalgamation, you need to understand what you have to offer, what you can offer the other practice, and what you are looking to get out of it. There will also usually be areas of tidying up to be done to get your practice in as good order as it can be, be it in terms of operational controls, staff efficiency, quality standards, borrowing levels, practice profitability or whatever. It is quite a long master list, but really important.

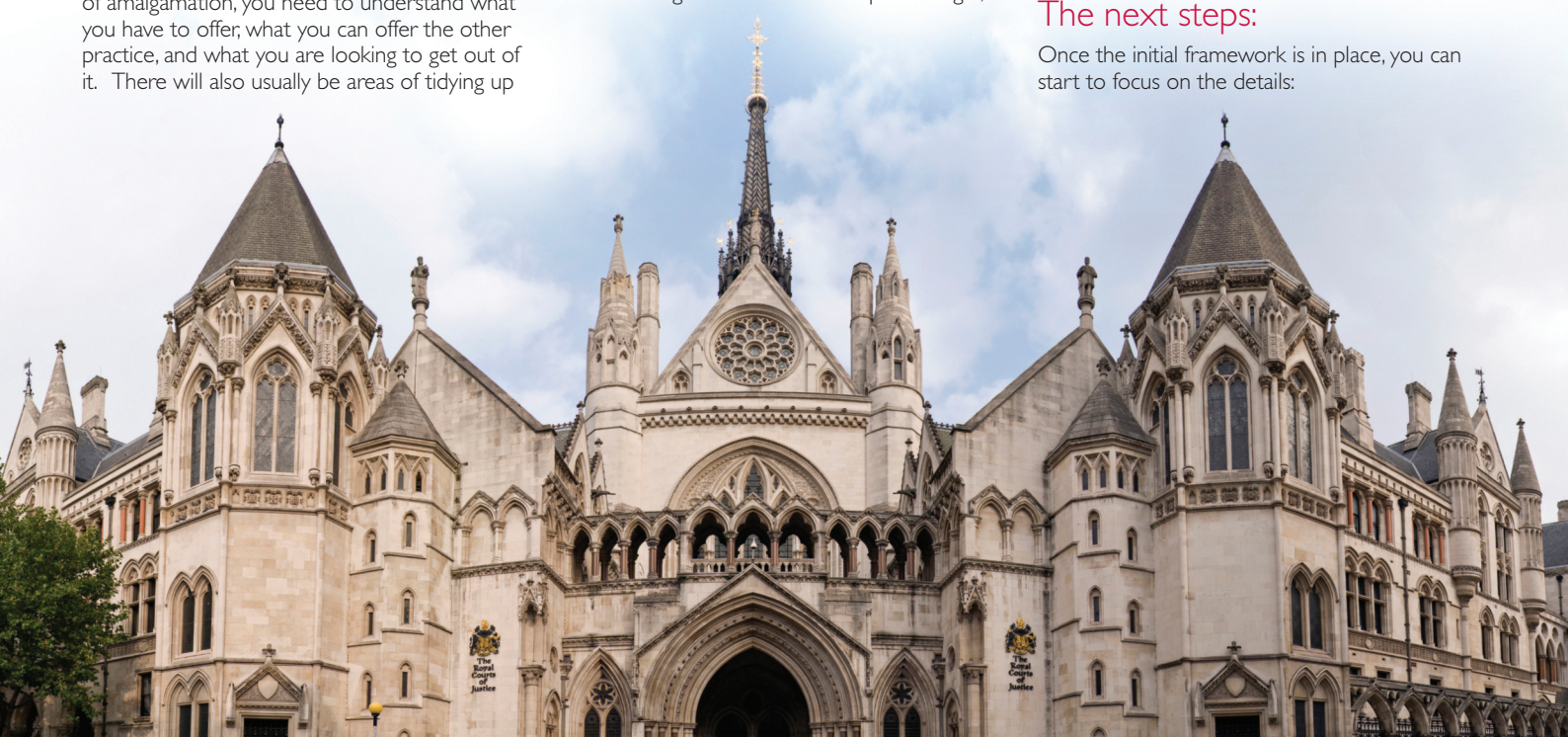
Initial agreement with a potential merger partner

Rather than getting bogged down in detail initially, you should draw up a list of the most important matters only for discussion, and these should normally include:

- Offices - which will you keep and which will need to go?
- Key clients - there may be some high value key clients which may be very attractive to merging firms (but be careful of over-reliance on a small client base).
- Ownership and management structure - will all existing owners be owners post merger, or consultants, employees, there at all, etc.?
- Headline financial performance - how likely is it to match reasonably well?
- Owners' capital versus third party borrowings - again, can it be made to fit? There are all sorts of ways of looking at this.
- Onerous liabilities - are there any large claims ongoing that are not obvious?
- Structure of the new practice - LLP, partnership or limited company? We will not look at structure choices here as we have discussed these in detail in previous Legal Focuses, but there are so many different combinations that we recommend you get detailed advice quite early on.
- Timetable / responsibilities - be clear who will be driving the project and set realistic timescales. These things have a tendency to drift.

The next steps:

Once the initial framework is in place, you can start to focus on the details:



- Draft up your heads of terms.
- Start to think about how you will go about aligning working practices, ie how do the existing practices operate? Time recording processes, number of fee earners per owner, per secretary and so on, administrative responsibilities etc.
- Choice of main banker.
- Client conflicts.
- Choice of name - sometimes this can take longer and cause more issues than many other points.
- Legal issues.
- Accounting and tax complexities.
- Draft up a detailed work programme for the project.

Financial forecasts:

It is vital that you make an early start in putting together some forecast financial information. This should be as true a reflection as possible and you should base the forecasts on the merged practice, rather than the component firms.

The forecasts should cover as much detail as possible and we would recommend you invest in bespoke software for this purpose - you will be grateful for this in the future.

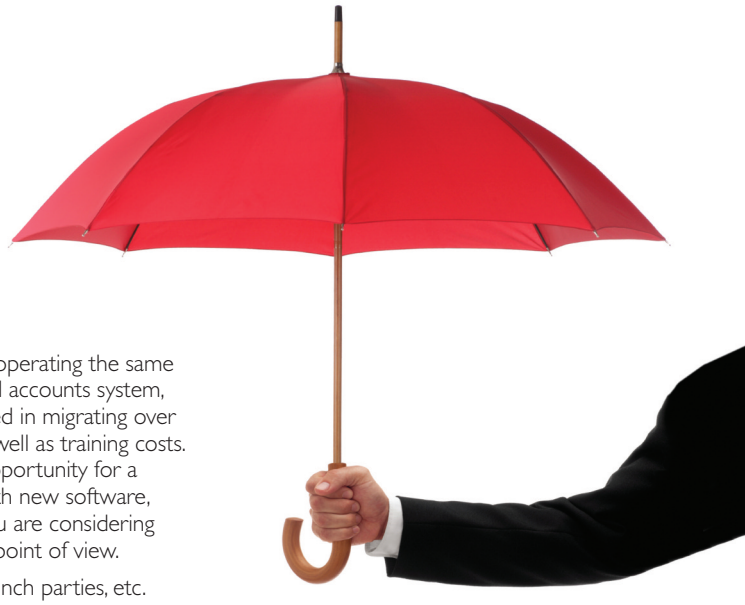
There will be some short term costs associated with the merger and it is important that these are not forgotten as they may have a significant cash impact in the early days. Do not underestimate the costs involved.

- Rent - including any vacated offices.
- Dilapidations - are there any dilapidations clauses written into your leases, especially those that you do not intend to renew?
- Redundancy payments.
- IT - unless all parties are operating the same practice management and accounts system, there will be costs involved in migrating over to the chosen system as well as training costs. Or, you might take the opportunity for a completely fresh start, with new software, hardware etc. Perhaps you are considering linking offices from an IT point of view.
- Rebranding, stationery, launch parties, etc.
- Potential tax payment acceleration.

Other considerations:

Due diligence is a piece of work that is so important to merging firms, but it is often neglected (and sometimes not really done at all). We divide it into two categories, financial and non financial. Financial due diligence consists of a thorough review of key financial risk areas such as the reliability of management information, WIP valuation, claims and complaints history, key financial control procedures and much more. If done properly, it should eliminate unwanted surprises later.

There may be personnel issue to deal with, such as pay differentials between practices, working hours, duplication of skills, holiday arrangements and changes in working locations. Deal with them early and find a fair compromise, but be realistic and concentrate on what will benefit the merged practice in the future, not the individual practices!



Similarly, there will usually be cultural issues to tackle, and it is important that there is a dominant party to drive leadership and the required changes. This should be decided early and clear responsibilities should be set.

Summary:

Make sure that both sides are fully committed and have a similar outlook before you get into the detail.

You really do need to be focused from the start, but be realistic about the timetable - allow two months for courting and a further three months for implementation.

Implementing a merger is a major project - there are lots of challenges but also lots of opportunities, but remember to try to make the process as enjoyable and open as possible.

Annual Investment Allowances are changing

As many of you know, the current Annual Investment Allowance (AIA), which allows businesses to claim 100% tax relief on most normal fixed asset purchases in respect of plant and machinery up to an annual limit of £100,000, will change on 31 March 2012, with the limit being reduced to £25,000.

From this date, tax relief on any assets purchased above this lower limit will be restricted to normal annual writing down allowance and, in most cases, this will be 18% of the tax written down value.

Major structural work involving floors, wall, windows etc, will normally fall outside the definition of plant and machinery but, say, a major IT project or significant purchase of office equipment would probably be covered.

There is therefore a potential tax cash flow advantage in ensuring that any major expenditure of this type takes place before the end of March 2012, so that the maximum available tax relief can be claimed as quickly as possible. What you do need to bear in mind though is how the timing of these changes work with your accounting year end as, depending on when your year end date falls, the ability to claim the full £100,000 may be pro-rated.

For example, a company that prepares its accounts up to 31 December 2012 would calculate its maximum AIA entitlement based on:

(a) the proportion of a year from 1 January 2012 to 31 March 2012, that is, 3/12 x £100,000 = £25,000; and

(b) the proportion of a year from 1 April 2012 to 31 December 2012, that is 9/12 x £25,000 = £18,750.

The company's maximum AIA for this transitional chargeable period would therefore be the total of (a) + (b) (£25,000 + £18,750 = £43,750), although in relation to (b) (the part period falling on or after 1 April 2012), no more than £18,750 of the company's actual expenditure in that part period would be covered by its transitional AIA entitlement. That is, you would still need to make sure that sufficient assets were purchased before 31 March 2012 to make full use of the £25,000 element of the AIA.

Before you rush out to try get everything in place before this date however, it is important to bear a few things in mind to avoid falling short of HMRC's exacting standards regarding the purchase of qualifying assets.

Allowances are normally given when expenditure is 'incurred', and the general rule is that expenditure is incurred on the date when the obligation to pay becomes unconditional, whether or not a later date for payment is specified. However, this

is not as simple as merely ensuring the date on the supplier invoice is pre 31 March.

HMRC consider that whether an obligation to pay has become unconditional depends on the terms of the particular contract, and in order to claim the AIA the asset must either:

- have been **paid for in full** by 31 March 2012 for incorporated businesses or by 5 April 2012 for individuals or partnerships (if part payments have been made, the part payments will qualify); or
- have been **brought into use** by 31 March 2012 for incorporated businesses or by 5 April 2012 for individuals or partnerships if being paid for under **Hire Purchase**; or
- have been **delivered** by 31 March 2012 for incorporated businesses or by 5 April 2012 for individuals or partnerships if payment has become unconditional on delivery, as long as payment is made within 4 months; or
- where the asset has not been delivered or brought into use, there is still an unconditional obligation to pay, as long as payment is made within 4 months.

This last point may be difficult to actually get right, given that there will be some judgement required to ensure that the correct criteria have been met. We would recommend that you seek advice under these circumstances.

Where payment is made by bank loan, the instalments should not be caught in the same way as Hire Purchase payments.

In summary, the closer we get to the end of the tax year, the more you will need to get your documentation right for purchases. If possible, it would be a good idea for the delivery date to be specified on the sales invoice if it isn't already.

If you need any more guidance as to what falls into the qualifying category for AIAs and how best to get your paperwork in order, then we would be more than happy to assist.

New Business plan and forecasting service

We have just teamed up with SIFA (Solicitors Independent Financial Advisers) to offer practices a bespoke yet straight forward service to create the business plans and financial forecasting needed to comply with the new COFA regulations. This is a fixed price offering designed for smaller practices, and offers excellent value for money.

Further details can be found in the legal section of our website (www.hazlewoods.co.uk) or email us at legal@hazlewoods.co.uk.

2011 Law Society Benchmarking Survey

As many of you will know, we write the Law Society's annual Financial Benchmarking Survey. The 2011 survey is now at the printers and will be with all who participated in it very soon.

Anyone who did not participate can purchase a copy by following this link: www.lawmanagementsection.org.uk

Solicitors' Accounts Rules Training Days

We regularly hold SAR update sessions for practice accounts teams and, as well as providing valuable training, they allow attendees to chat to each other and compare notes on a whole range of topics. We will be holding further sessions during 2012 and dates and venues are set out opposite.

To register your interest, please follow this link: www.hazlewoods.co.uk/events.aspx

Alternatively, you can call Helen Carter (01242 680000), or email legal@hazlewoods.co.uk

13 March	Bristol Golf Club, Bristol
14 March	St Mellon's Hotel, Cardiff
15 March	Hatherley Manor, Gloucester

Potential VAT reclaim for repairs and maintenance of motor cars

Most of you will already know that the VAT charged in respect of the repair and maintenance of cars owned by the business can be recovered.

What some people overlook is that the input tax can be recovered in full even if there is substantial private use. This is all subject to the normal rules for partially exempt businesses.

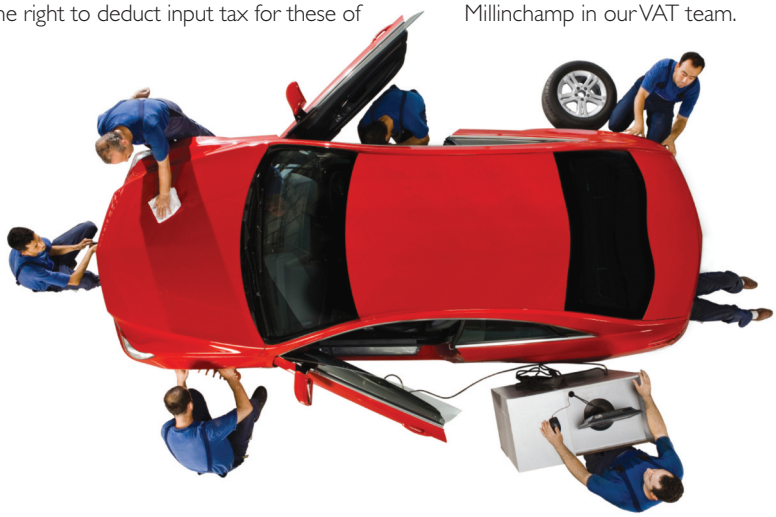
Something that is even less commonly understood is that, where a business pays the full cost of the repairs and maintenance of an employee's or partner's private car, again the VAT incurred may be treated as input tax and recovered in full.

This is provided that there is at least some element of business usage and the costs are recorded in the business accounts.

The right to deduct input tax for these of repairs and maintenance costs is not in any way conditional on how the business deals with VAT on road fuel for private use. Therefore, even if no VAT is reclaimed on fuel (i.e. in order to avoid declaring the additional output VAT on fuel scale charges), the above principles would still apply.

Businesses which may have under claimed this type of VAT in the past may submit a retrospective claim to cover all VAT periods for which the due date for submission of the VAT return would have fallen within the past four years.

This could amount to quite a decent size claim for some businesses and we would urge you to review your past records as soon as possible to find out whether this applies to you. We would be more than happy to help and advise you if you would like to speak to Adam Lloyd or Julian Millinchamp in our VAT team.



Welcome to Ross Parry

We welcome a new face to the Hazlewoods Business Recovery Team, with a distinct link to our Legal Team.

Ross Parry has joined us from PricewaterhouseCoopers (PwC) Insolvency office in Gloucester as a director in our expanding Business Recovery and Insolvency team.

Ross will be working closely with the current partners, Phil Gorman and Peter Frost, to strengthen our position in the local market and also help expand our newly opened insolvency offices in Bristol and Devon.

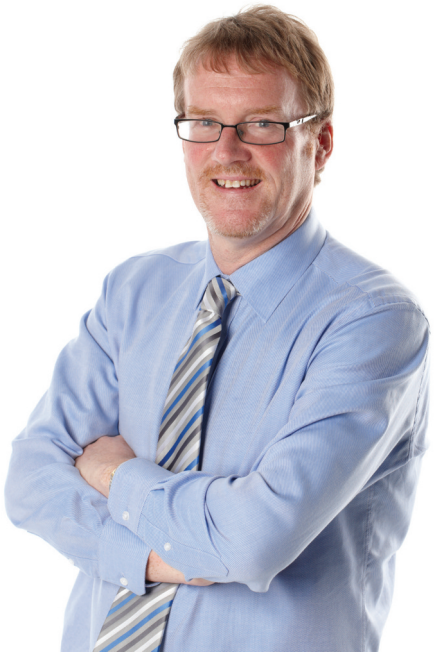
He brings a depth of experience in all main areas of insolvency, dealing with consumer debts, partnerships, sole traders and limited companies and advising in areas such as Company and Individual Voluntary Arrangements (CVA's and IVA's), voluntary liquidations and administrative receiverships.

For the last 15 years Ross has headed PwC's work winning team for bankruptcies and he brings further personal insolvency expertise to our well established team.

Over the years Ross has developed very strong relationships and advisory skills with over 100 insolvency lawyers and he will be bringing these special relationships to our Legal Team.

Ross is no stranger to Hazlewoods, having started his accountancy career with us in 1981 before joining our very own Phil Gorman and Pete Frost at the then named Deloitte, Haskins & Sells (now PwC) to begin his career in Insolvency.

Outside work, Ross is a keen cricketer, where he has played for Churchdown for over 30 years. He is also an enthusiastic golfer and a season ticket holder at Gloucester Rugby Club.



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