



MOORE STEPHENS

CHARTERED ACCOUNTANTS

PRACTICE MANAGEMENT -

**WORKING CAPITAL
MANAGEMENT**

MICHAEL BARNETT ACA

**Young Solicitors Association
23 November 2007**

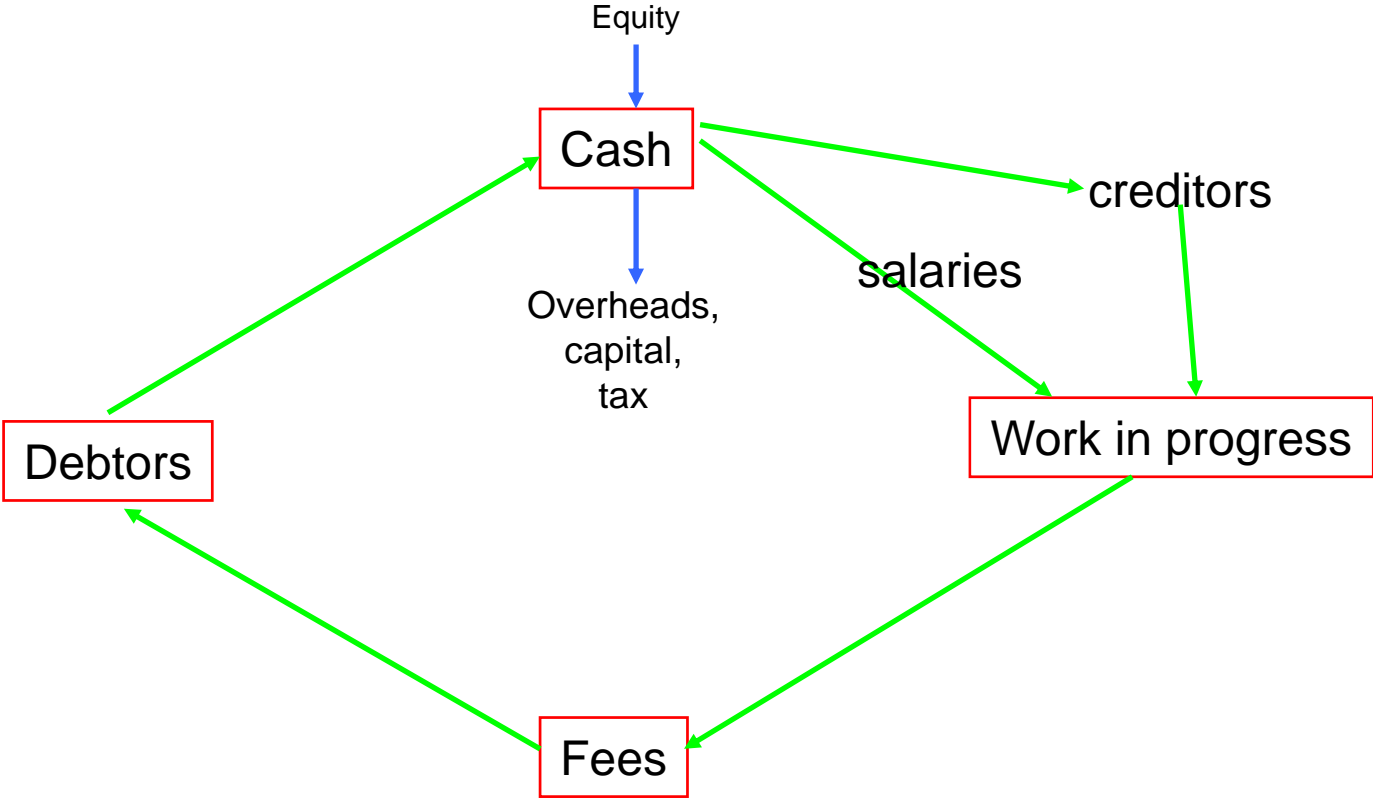




Cash

- Lifeblood of every business
- (should be) every fee earners' task to keep it flowing to maximise profits

Working capital cycle





Working capital requirement

Finance required to fund the business:

| | |
|---------------------------------------|--------------|
| Work in progress | X |
| add: Debtors / unbilled disbursements | X |
| less: Creditors | <u>(X)</u> |
| Working Capital Requirement | <u>X</u> |



Work in progress

UITF 40

- Accounting guidance on the recognition of income
- Income to be recognised on a 'work done' basis
- Profits are recognised earlier
- Tax is paid earlier



UITF 40 example

ABC Solicitors

Fee £12k

Costs £8k

Profits £4k

- Work commenced 01/10/06
- Work completed 31/01/07
- Fee note raised 30/04/07
- Fee paid 31/08/07
- Year End 31/12/2006

Example (cont'd)

| | Previously | | UITF 40 | |
|---------------|--------------|--------------|--------------|--------------|
| | 2006 | 2007 | 2006 | 2007 |
| Op WIP | - | (6,000) | - | (9,000) |
| Fees | - | 12,000 | - | 12,000 |
| CIs WIP | 6,000 | - | 9,000 | - |
| INCOME | 6,000 | 6,000 | 9,000 | 3,000 |
| Costs | (6,000) | (2,000) | 6,000 | (2,000) |
| PROFIT | - | 4,000 | 3,000 | 1,000 |



Work in progress

- to manage WIP it must be measured
- rational must be robust
- evidence
- 3 main WIP recording systems
 - » Rule of thumb
 - » stocktake approach
 - » time recording
- Note: alternative rules for contingent fees

WIP - alternative rules

| COST BASIS | INCOME BASIS |
|---|---|
| Speculative work | Contract |
| Contingent fees | Agreed / expected fee |
| Not reached the point where there is a right to consideration | Estimate of completion / work required to complete work |



Rule of thumb

- Example:

- » annual fee income £2.4m
- » average case length 4 months

- » $WIP = (£2.4m \times 4/12 \times 50\%) = £400k$

- NOT RECOMMENDED

- Little defence in HMRC enquiry



Stocktake approach

- Case by case approach
- Record of all ongoing cases at year end
 - » review of matter listing
 - » review of case files
- Determine % completion of each case
- Determine fee for each case (excl disbursements)
- Do the sums

'Stocktake' example

| Client | % complete | Est. fee | Accrued income |
|---------------|-----------------------|-----------------|---------------------------|
| Mr Allen | 75% | £2,000 | £1,500 |
| Miss Brown | 60% | £6,000 | £3,600 |
| Mrs Crosse | 30% | £5,000 | £1,500 |
| | | | <hr/> £6,600 |



Volume cases

Where it can be demonstrated:

- large number of cases
- similar nature
- clearly defined stages
- average profile

Maybe sufficient to:

- record number of cases per stage
- derive average fee
- do the sums



Volume case example

Typical case has 3 stages A (40% complete), B (65%) and C (90%); average fee is £800.

Firm has 1,200 cases: 350 at stage A, 400 at stage B and 450 at stage C

Accrued income

$$\begin{aligned} &= ((40\% \times 350) + (65\% \times 400) + (90\% \times 450)) \times £800 \\ &= (805 \times £800) \qquad \qquad = £644,000 \end{aligned}$$

BUT

- must retain sufficient records to show basis of judgements made, percentages used etc, etc



Time recording

- Best approach - not just for WIP/AI purposes
- Timesheets
- Must be complete
- Allows progress of each individual case to be established



Time recording - valuation

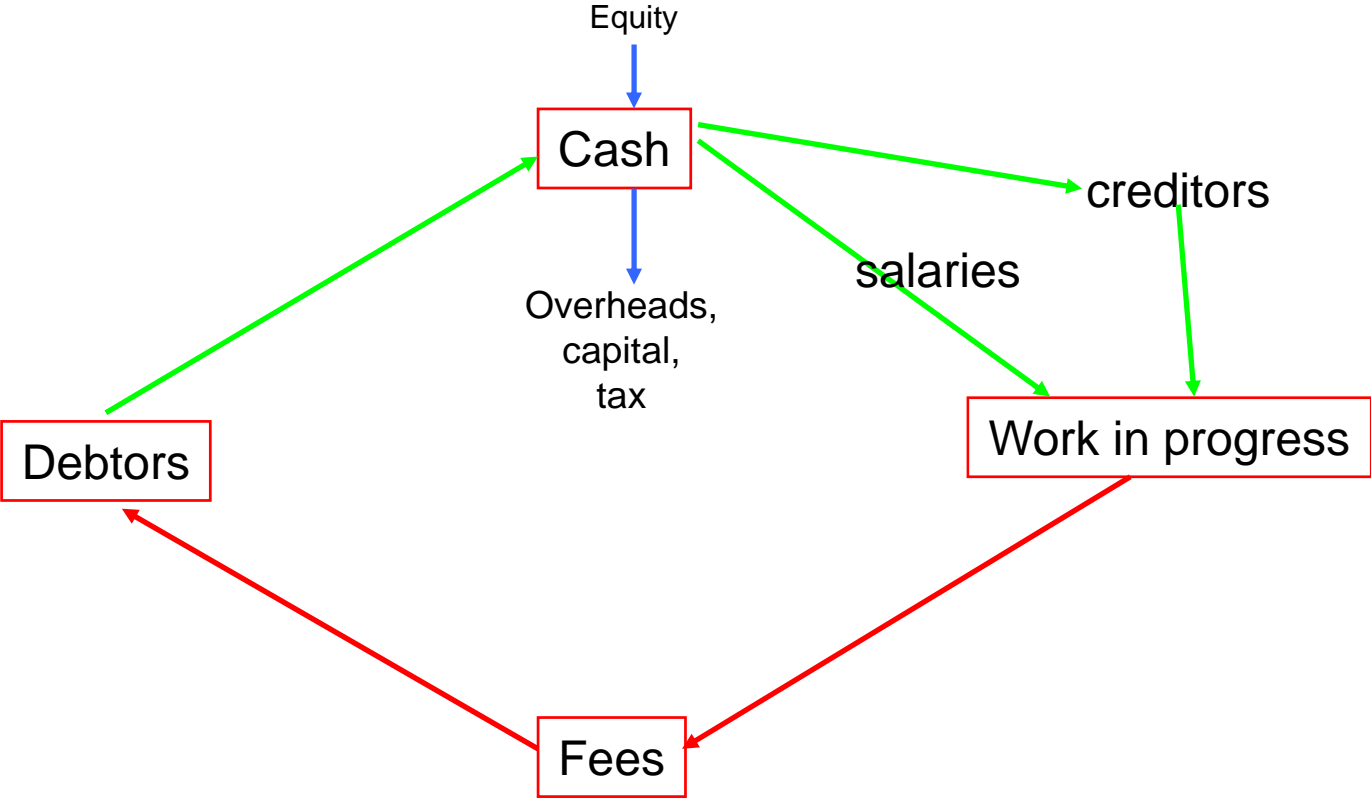
- Assign 'charge out' rates to each member / level of staff
- Consider different 'charge out' rates for different types of client
- Perform recovery review at year end



Fundamental points

- Have a system
- Keep it up to date
- Ensure it has credible information
- Be prepared to have it subjected to HMRC enquiry

Working capital cycle

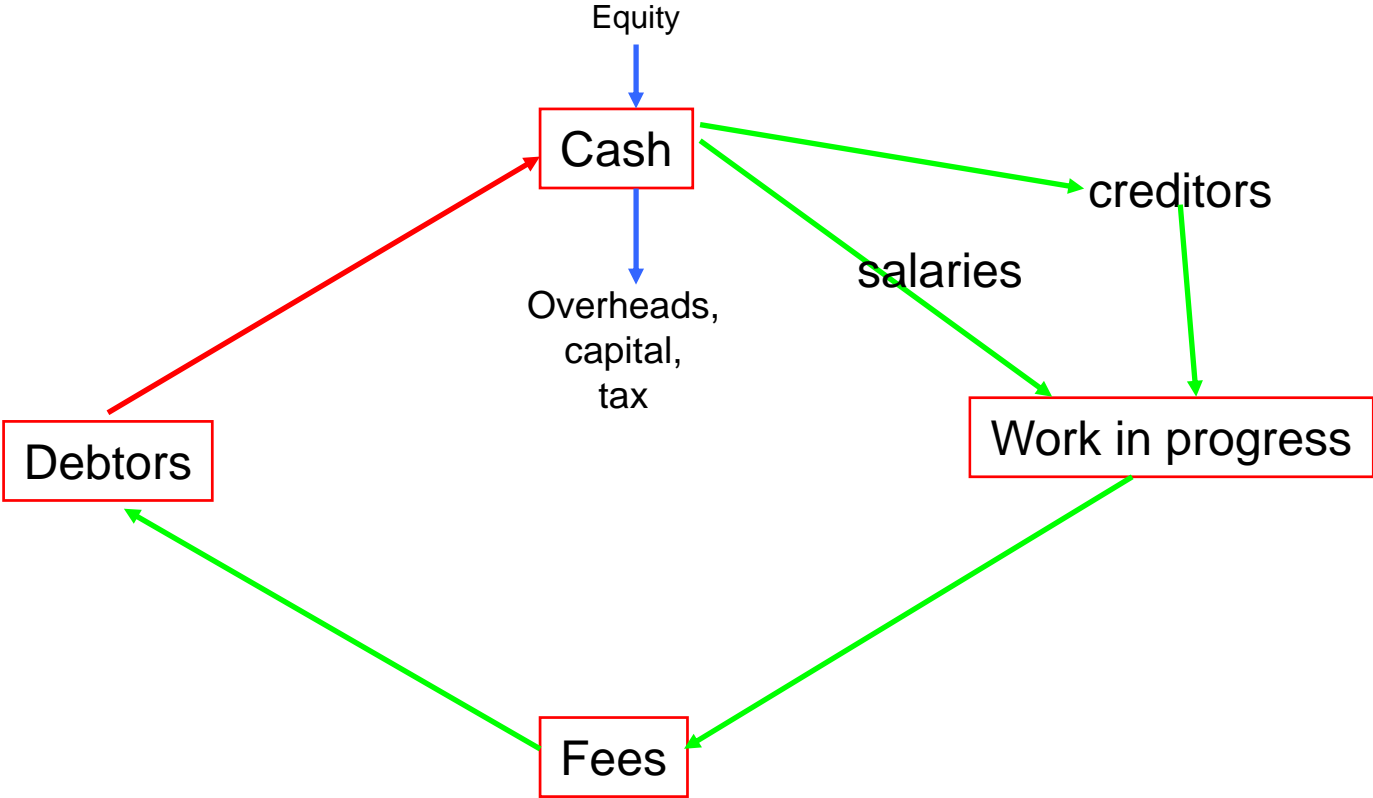




WIP to Debtors

- Faster completion
- Earlier billing
- Interim billing (monthly)
- Solicitors Accounts Regulations 1998
- VAT implications

Working capital cycle





Debtors to cash

- Effective credit control
 - » Credit controller
 - » Out-source
 - » Discounts
- Raise Bills of Costs against clients funds
- Controls to ensure all recoverable disbursements are identified
- Client deposits to cover high level of disbursements



UITF 40 example

ABC Solicitors

Fee £12k

Costs £8k

Profits £4k

- Work commenced 01/10/06
- Work completed 31/01/07
- Fee note raised 30/04/07
- Fee paid 31/08/07
- Year End 31/12/2006

UITF 40 example

Opportunity cost of financing working capital:

| | |
|----------------------|-------------|
| • 1/10 - 31/1 | £ 80 |
| £4000 x 6% x 4 mths | |
| • 1/2 - 30/4 | £180 |
| £12000 x 6% x 3 mths | |
| • 1/5 - 31/8 | <u>£240</u> |
| £12000 x 6% x 4 mths | |
| | <u>£400</u> |

£4,000 profit -> £3,600 profit

- Work commenced 01/10/06
- Work completed 31/01/07
- Fee note raised 30/04/07
- Fee paid 31/08/07
- Year End 31/12/2006




Other cashflow issues

- SAR 1998 - Expired disbursement cheques
- Legal Aid payments
- Borrowings



Client contracts

- Recognise income in line with performance of contractual obligations
- Generally pro rata time incurred
- Contingent or conditional income (e.g. success fees)
- Payment terms



For further information

Michael Barnett

E-mail: mbarnett@msca.co.uk

Telephone: 028 9032 9481

Moore Stephens, Donegall House,
7 Donegall Square North, Belfast BT1 5GB