

Solicitors Advisory Service News

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Welcome to the latest edition of our half yearly bulletin to law firms. This edition takes an in-depth look at the current issues facing the profession and offers insight to help practices prepare for the changing market place. These issues can be viewed as a challenge, or an opportunity but with the 7000 high street practices predicted to fall to around 3000 over the next few years it is wise to be both realistic and well prepared. Take a read through the article on mergers which looks at how firms can ensure they are in a dominant position moving forward.

Also in this issue Michael Swift our Director of Forensic Services introduces our new area of expertise - forensic and litigation support. Michael discusses the complexity of Ogden 6 Table and offers training in this area.

Please also note our invitation to have future updates in electronic form.



Yvonne Wood, Managing Director

LEGAL DISCIPLINARY PRACTICES

The Solicitors Regulation Authority (SRA) aim to be ready to regulate LDPs by 1st March 2009. This will enable practices to include other kinds of lawyer amongst their partners, members or shareholders. This includes barristers, legal executives and licensed conveyancers as well as allowing up to 25% of partners, members or shareholders to be non lawyers as long as they are also managers within the practice.

This is not an opportunity for outside investment or to allow practices to offer other services, but it will allow practice directors, internal accountants and other internal professionals to take part in the ownership of the business as long as the

practice can demonstrate that they are "fit and proper".

The SRA are also moving from regulating individuals to regulating the firm in which they work.

ALTERNATIVE BUSINESS STRUCTURES

Alternative Business Structures differ from LDPs as these new business units will enable firms to offer multi disciplinary services and the possibility of some external ownership. These structures will not be available until at least 2012 and the SRA warn against prior arrangements such as option agreements, as these would be in breach of current regulation.

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BEST VALUE TENDERING

Best Value Tendering will commence in Manchester in 2009 for Police Station and Magistrate Court work. It is then proposed to roll this out across the country learning from any issues arising in the pilot scheme.

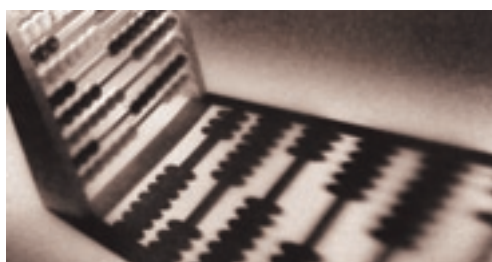
Practices need to understand the cost base of their business and/or criminal department to address inefficiencies and develop the ability to tender.

UNDERSTANDING COST

With the onset of Best Value Tendering and other fixed fee pressures within the profession, as well as other financial pressures, it is essential that practices understand the cost base within their business. It is often not clear from a set of financial statements what the true costs of the business are. It is essential to include all costs within the business such as notional salaries for partners, directors and members, interest on capital accounts and rent for any property used within the business but not charged at a commercial rent.

In the table below we show the adjustments that may be required in a practice and then follow on to show how this may be further filtered down to show cost per hour.

This is very similar to the old "expense of time" calculation.



	Unadjusted		Adjusted	
	£'s	£'s	£'s	£'s
Fees		1,750		1,750
Salaries	675		675	
Notional			390	
		675		1,065
Gross Profit		1,075		685
O'heads	570		570	
Notional Rent			20	
Notional Interest			35	
		570		625
Net Profit		505		60
Total Cost Base		1,245		1,690

Capacity

	Number	Hours	Capacity
Equity Partners	6	1,000	6,000
Salaried Partners	1	1,200	1,200
Solicitors	6	1,200	7,200
Other Lawyers	4	1,200	4,800
Para Legal	4	1,200	4,800
Trainees	1	800	800
	22		24,800

Cost per hour $\text{£}1,690,000/24,800 = \text{£}68.15$

Lord Carter's Review of Legal Aid

Procurement 2006 survey showed that the cost per hour ranged from £40 to £60 with the costs of larger firms being much lower.

Costs can be dissected further to enable a clearer picture to be seen by grade of fee earner.

Equity Partners	
Salary	65,000
Secretary	18,000
Overheads & Central Salaries	40,000
Total	123,000
Hours	1,000
Hourly cost	£123.00
Salaried Partners	
Salary	50,000
Secretary	18,000
Overheads & Central Salaries	40,000
Total	108,000
Hours	1,200
Hourly Cost	£90.00
Solicitors	
Salary	32,000
Secretary	18,000
Overheads & Central Salaries	40,000
Total	90,000
Hours	1,200
Hourly Cost	£75.00
Other lawyers	
Salary	25,000
Secretary	-
Overheads & Central Salaries	20,000
Total	45,000
Hours	1,200
Hourly Cost	£37.50
Trainees	
Salary	20,000
Secretary	-
Overheads & Central Salaries	20,000
Total	40,000
Hours	800
Hourly Cost	£50.00

For those who wish to cover this confusing area in more detail please e-mail or call us or speak to us when we next meet.

ACCOUNTING FOR REFERRAL FEES

When we are considering how to treat referral fees paid for personal injury cases we have to consider whether an asset has been created at that point in time. If referral fees are paid before an asset has been created and the fees are not transferable to a new case if the original case fails, then the fees must be written off to the Profit and Loss account as they are incurred, and are not carried forward to match against future revenues. Under current reporting standards it is incorrect to use the argument that on average a firm wins 90% of cases therefore it should carry forward 90% of referral fees and also account for 90% of its work in progress at fee value. This can put a large hole in the financial statements of practices that specialise in personal injury and at the very least a note should be included in the accounts to acknowledge the treatment. We are hearing of an increasing number of HMRC enquiries looking into this very issue. The ICAEW solicitors' special interest group have written to the Accounting Standards Board for further clarification to ensure that there is a level playing field where all firm's accounts are prepared on a consistent basis.

MERGERS

Practices are focusing on consolidating the services they offer, appraising their cost structure and looking at opportunities to strengthen their position. In a market that is facing, what can only be described as one of the biggest sweeping changes that it has ever experienced, many are seeing mergers as the only way of addressing these challenges that lay ahead.

As a guide, we have noted issues which must be addressed if the merger option is to be a successful one:

1. Identify what your strengths and weaknesses are. This will pinpoint the factors that will make you attractive for other parties who you may wish to merge with, and to assist you in identifying potential partners who may help to strengthen those areas of weakness.
2. Identify the threats and opportunities specific to your practice. You know the factors that are affecting the market as a whole, but look closer to home at your own client base and local competitors. These can be matched to your

strengthens and weakness to identify whether you are currently in a position to deal with the issues identified and to help you focus on the issues that need to be addressed in order to make any merger a success.

3. Carry out the above exercise for any potential target practice to identify if what they have to offer is what your practice needs to achieve the optimum results that the merger can bring. What does the other practice bring to the table that can benefit you - market presence, expertise, cost savings? Find the target that can provide the greatest opportunities to achieve your goals.
4. Are the cultures of the two practices compatible? However promising the benefits of mergers look, the success or failure can very often depend on the culture of the two parties. If the practices are so dissimilar then either the marriage will fail or the full potential will be lost, however well the merger is managed.

Putting all these points aside, one overriding issue which could determine whether you are in control of your future to achieve your desired outcome is the fact that you should be the driving force behind any decisions you make. Don't be driven by the other party, otherwise you may only succeed in achieving their objectives and not your own. With this in mind, would a takeover approach, rather than a merger be more appropriate. Be pro-active in looking for potential partners; don't wait to be approached by others. The more pro-active and dominant you are, the more likely it is that you can achieve your objectives, whatever they are – be the hunter, not the hunted!

QUALITY STANDARDS

The progress of solicitors' firms towards achieving Lexcel accreditation is gathering momentum. Currently 1,050 practices have either achieved such accreditation or have made a commitment to achieve it. 16 of the "top 100" firms now hold such accreditation. Another quality standard that is popular in the legal sector is Investors in People, which is broadly about developing people to achieve business objectives.

When not delivering training on anti money laundering procedures, Peter Lane, our resident management consultant, assists solicitors' firms to achieve such standards. He also conducts assessments against these standards on behalf of various quality assessment centres.

The attractions of Lexcel include:

- Providing a framework for supervision and the control of the quality of legal casework, including through a sample file audit system.
- An externally assessed risk management system, leading to lower professional indemnity insurance premiums.
- Enabling firms to be included on panels or bidding lists for institutional clients.

Although this has never been put forward as a selling point, there appears to be a tendency for Lexcel accredited firms to be viewed as attractive for a proposed merger.

For further information regarding quality standards, please contact Peter Lane, peter.lane@bennettbrooks.co.uk

SOLICITORS ACCOUNTS RULES AND BILLING

Considered by many as a necessary evil, but in today's climate where "Cash is King", to get the cash in, those bills need to be done, and throw in the added complications of the Solicitor's Accounts Rules, it can become an even bigger headache.

Here are some pointers as to what the SRA are currently focusing on and other areas where those bills quite often do not come up to scratch:

- Avoid the 'secret profit' – recent SRA visits appear to be focusing on the billing of certain costs which many practices charge to the client with a small fee attached. The most common such costs are the recharging of TT fees. The cost incurred by the solicitor for a TT fee can be £35 per transaction which many add on a small administration fee, which means the client is charged, say, £50 in total. Many solicitors are including this £50 charge on the bill as a disbursement. This is considered to be incorrect as the cost of the disbursement is not £50, but £35 with £15 being extra profit cost, therefore making a 'secret profit'. All profit costs should be clearly marked on the bill so the client is fully aware as to what is profit costs and what are disbursements. If the TT fee is to be included as a disbursement, then it should only be done so at the value incurred, with the extra fee being included within the profit cost element, or alternatively, the entire amount should be included within the profit costs.
- A common oversight on bills is the recording of disbursements. Rule 32 of the Solicitors Accounts Rules states that bills and notifications of cost should distinguish between fees, disbursements not yet paid at the date of the bill, and paid disbursements. This does not need to become an extra administrative burden. One option is to include on your standard bill template that 'all disbursements included on the bill are paid, unless otherwise stated' which avoids the need to comment on each individual disbursement that is to be included on the bills.
- One rule which appears to be commonly breached is Rule 19 which stipulates that once a bill of costs has been raised, monies held in the client account earmarked for costs, becomes office monies and must be transferred out of the

client account within 14 days. This on the face of it seems relatively straight forward, however, a condition of raising a bill is that the solicitor must 'properly require payment', meaning that the work has actually been done, whether at the end of the matter or at an interim stage. This is further complicated in areas such as conveyancing where final bills are often raised at exchange, whereas the date of completion is the point at which they properly require payment. These factors have been the cause of great confusion and factors that have contributed to breaches on many Accountant's Reports, and has resulted in ongoing discussions at the SRA. One option to avoid the confusion and possibility of a breach on your next Accountant's Report, is to include on the bill a comment which clearly states that the bill is not deemed payable until the date of completion. The client clearly knows the date the fees are due and at which point any monies held in the client account will be earmarked as office monies, from which date the solicitor has 14 days to transfer the funds over to the office account.

OGDEN 6 TABLES

The Ogden 6 Tables, which came out last year, are giving rise to a number of problems. One of the issues is the appropriate discount to be given to a claimant who is injured and suffered a permanent disablement. The Ogden 6 Tables suggest that separate calculations should be made of the projected future earnings multiplicand the Claimant would have received but for his injury (I), and the projected future sedentary earnings multiplicand as a result of his injury (II). To those multiplicands separate multipliers are applied which take account of the pre-accident and post accident prospects in respect of contingencies other than mortality and then (I) is reduced by (II) to give the anticipated loss. The tables used for assessing the contingencies are Table A (males not disabled) and B (males disabled) and Tables C (females not disabled) and D (females disabled).

If these tables are applied directly from Ogden 6 then large differences in the multipliers will arise. For instance, a multiplier for a male without any qualifications but employed and who is in the age group 35-39, a factor of 0.89 (Column O Table A) would be applied to the multiplier in respect of his pre accident

not disabled status. Whereas in his post accident disabled status a factor of 0.48 (Column O Table B) would be applied. This is to take account of the possibility that in his post accident disabled state he is more likely to be vulnerable in the employment market.

Thus, on the basis of the following example, it will be seen that there could be a large difference between the likely pre and post accident earnings and accordingly the claim.

Example:

Net earnings prior to accident as a labourer say £18,000. Net post accident earnings as a car park attendant after the accident £8,000.

Multiplier for future loss, say age 37 Table 9 at 2.5% = 19.56

Calculation of Loss:

£18,000 x Multiplier	
17.41 (19.56 x 0.89)	£313,380
£8,000 x Multiplier	
9.39 (19.56 x 0.48)	£(75,120)
Potential loss of earnings	£238,260

Prior to the issue of the Ogden 6 tables the calculation would have been (£18,000 - £8,000 x 19.56 x Ogden 5 discounts say 0.94) = £183,864. Thus the application of the Ogden 6 Tables have increased the Claim by £54,396 (£238,260 – £183,864).

It should be noted that the application of the tables are intended to be a “ready reckoner” which provides an initial adjustment to the multipliers and it may be appropriate to argue for higher or lower adjustments in certain cases. In particular, attention should be given to the interpretation of disabilities given in the tables.

A recent case has confirmed that the figures shown in the tables are not cast in stone and should reflect the circumstances of each case. In *Conner v Bradman and Company Limited* (14 November 2007) the agreed multiplier was 11.40 and the tables indicated that the adjustment factor should be 0.49 to give a multiplier of 5.586. The Claimant’s suggested that the Ogden Tables are based on detailed actuarial evidence and should not be the subject of impressionistic “tinkering” by the judge. The judge however referred to *Kemp and Kemp* and noted that in the introduction to the Tables that “the relatively low threshold required to the definition of “disabled” will result in the need for potentially significant adjustment depending on the extent of the Claimant’s disabilities. This will have to be considered on a case by case basis”.

The judge considered that the adjustment factor of 0.49 should be adjusted and, on the basis that the figure for a claimant who is not disabled where the figure is 0.89, he acceded to the Defendant’s suggestion that the figure of 0.655 should be used as the middle course between the two extremes in this case.

Therefore it appears that the adjustments can be the subject of tinkering and it is appropriate to obtain as much evidence as possible to support your case. Such evidence may be, obtaining a detailed CV for the Claimant, a review of his employment record, details of his employer’s opinion on his work and the security of his position, or, his National Insurance record. Medical opinion of his employment status bearing in mind his disabilities should also be obtained as part of the medical evidence.

Michael recently jointly presented a day course for APIL in London and Manchester on Fatal Accidents. As a result of the feedback he has noted that there is a considerable amount of interest in the Ogden Tables and a presentation devoted solely to them might be extremely useful to practitioners. Please contact Michael by e-mail michael.swift@bennettbrooks.co.uk if you would be interested and if there is sufficient interest he will make a presentation lasting approximately 90 minutes in the future at a convenient location.

TAX UPDATE

Payroll

The deadline for submission of the 2007/08 Employers Annual Return (P35) is 19th May. If the 2007/08 P35 is filed online, the Inland Revenue will issue a £100 online filing incentive (for employers with 50 or less employees). 2008/09 is the last year that the online incentive is available and will be £75. By 2010 the Inland Revenue will require all employers to submit their P35's electronically.

VAT scale charge for private motoring

Remember that for those employees provided with company cars and who are provided with fuel for private motoring that a VAT scale charge is payable to the VAT man. This is now based on the CO2 emissions of the car and not the actual amount of private usage. Don't forget about it as it is one of the first things the VAT inspector will ask to see when he reviews the business records.

The new table of VAT scale charges is to be used on your first quarterly return following 1st May 2008.

Deadline for submission of tax returns

You should be aware that 2007-08 is the first year that tax returns have to be submitted electronically if submitted after 31st October 2008. Paper returns can still be submitted for this year only, provided they are sent before 31st October 2008.

Tax return errors

HMRC have introduced one of the first pieces of cross cutting legislation. The legislation establishes new penalties which are designed so that:

- If people take reasonable care when completing their returns they will not be penalised.
- If they do not take reasonable care, errors will be penalised, and the penalties will be higher if the error is deliberate.
- Disclosing errors to HMRC early will substantially reduce any penalties due.

The new penalties are initially for errors on returns and documents for VAT, PAYE, National Insurance, capital gains tax, income tax, corporation tax and the construction industry scheme. For these taxes the penalties apply to returns or other documents for return periods starting on or after 1st April 2008 that are due to be filed on or after 1st April 2009.

Two conditions must be satisfied before the penalty can be charged:

- The document given to HMRC must contain an inaccuracy that leads to an understatement of tax,
- a false or inflated statement of a loss,
- a false or inflated claim to repayment of tax.

Childcare vouchers 2008-09

There was no increase in the tax free value of childcare vouchers in the 2008 Budget. All employers can still give their employees vouchers or pay for childcare directly worth up to £55.00 a week with no tax or NI charges. This is per employee not per child and can be part of a salary sacrifice scheme.



Spouse's wages

For those solicitors who employ a spouse within the business this is an area where HMRC are taking an extra interest . In order for the salary to be fully tax deductible in the accounts the payment must represent fair value for work undertaken, we also would recommend the following action:

- make a separate cheque/BACS payment into the spouse's bank account
- record this as wages in the company's records or follow the same procedure in exactly the same way you would for other employees
- provide a payslip
- have a job description setting out their duties.

Capital Gains Tax Changes

Fundamental changes have been made to the Capital Gains Tax ("CGT") legislation with effect from 6th April 2008.

The general rate of CGT is now 18% for all disposals (trading and investment assets). Indexation has now been eliminated and taper relief (which often had the effect of reducing the tax charge on business assets to 10%) has also been scrapped.

A new Entrepreneur's Relief has been introduced in respect of trading assets. This can still reduce the CGT charge to an effective rate of 10% - but only in respect of the first £1M of gains. This is a life time allowance and any gains in excess of £1M will be taxed at 18%.

There are various conditions which must be satisfied to obtain Entrepreneur's Relief. Some individuals, who previously qualified for taper relief and would have paid CGT at 10% under the old rules, may well find that they no longer qualify for Entrepreneur's Relief. Similarly a lot of trustees will find there has been an increase in their CGT rate to 18% because they may not qualify for the new relief.

For individuals and trustees who are worse off under the new rules it may well be possible to improve the situation so that they do qualify for the new relief and each situation needs to be reviewed carefully. Please contact Keith Pope at our Northwich office for further details.

OTHER NEWS

Going Green

If you would like to help us reduce our carbon footprint, please let us have details of your e-mail address so that in future we can send you an electronic version of this half yearly newsletter. Send your e-mail address to: e-newsletters@bennettbrooks.co.uk

ISA/PEP merger

On 6th April 2008, Personal Equity Plans were converted into Individual Savings Accounts. At the same time the annual ISA allowance was increased from £7,000 to £7,200; Mini ISAs are being abolished; A maximum of £3,600 can be saved in a cash ISA. Although the rules governing PEPs have been aligned with ISAs since 2001 investment managers have had to hold them in separate accounts but this required ceases with the merger which may result in a reduction in costs.

