COVID-19 – survival steps for law firms

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Peter Scott, Paul Browne and Karl Wingfield look at how to manage cash flow during these stressful times.

Cash management and stress testing

The full force of the COVID-19 pandemic is now hitting the UK with most law firms working well below capacity. The key challenge for managing partners, after ensuring the safety and well-being of staff, is to ensure firms survive this hiatus, which couldn't have come at a worse time with most firms 'year-ends fast approaching.

Prioritise collection and conservation of cash

Firms need to ensure their cash flow is secure, that they stay within their credit facilities, and that they are able to trade profitably—if not immediately, then in the near future – to ensure compliance with the SRA Code of Conduct for Firms, specifically:

'2.4 You actively monitor your financial stability and business viability.'

'3.6 You notify the SRA promptly of any serious financial difficulty relating to you.'

However, this can only effectively be done against the backdrop of up to date cash flow forecasts which are regularly stress-tested for a number of 'what ifs?', including:

- the loss of significant time recording
- a lack of new client instructions, and
- clients who are similarly experiencing severe financial pressures and are either unable to settle bills or are looking for more favourable terms

Stress testing is not a back of an envelope exercise. It must be done using robust models, consideration of a range of scenarios, with the results audited to ensure they are accurate.

Banks will expect to see stress-tested cash flow projections when considering firms' requests for credit and their provision increases credibility of a firm's financial management.

Specific actions to collect and conserve cash that firms should be undertaking include:

Collect cash

- Review every outstanding bill and assign one individual to collect each one. Particular attention needs to be paid to outstanding bills which are outside the firm's normal credit terms. In these cases, managing partners need to agree a specific action plan with the relevant lawyer or credit controller, including any discount or time to pay agreement, to ensure bills are paid quickly. The devil here is very much in the detail.
- Bill all existing work in progress (fees and disbursements) as soon as practicable and in accordance with the firm's terms and conditions (they often specify monthly billing, which isn't always actioned). Again, give particular attention to work in progress balances unbilled for 30 days, where managing partners need to agree specific billing plans with the relevant lawyers.
- Set realistic bill collection and work in progress targets for all practice groups and partners and monitor performance against them.
- Be flexible with new and existing clients about the pricing of new work.

Conserve cash

- Consider reducing partners' monthly drawings and deferring any other drawings, with no if's or but's, and if necessary, call for an increase in partners' fixed capital – this step will send a powerful and positive signal to your bank, other funders (including HMRC) and your partners and staff.
- For leaving and retiring partners, renegotiate repayment of capital or if not possible pay according to the maximum length of time permitted by the partnership agreement. It is worth revisiting the partnership agreement to identify which levers the firm can use.
- Seek reduced working commitments from staff, ensuring you maximise the benefit of the Government's Coronavirus Job Retention Scheme.
- Stop discretionary expenditure, stop investment expenditure, and renegotiate leases and other supply contracts.
- Take advantage of Government payment deferral initiatives – there are two automatic schemes in place already—firstly, firms do not need to make a VAT payment during the period 20 March 2020 to 30 June 2020, and, secondly, the self-assessment income tax payment due on the 31 July 2020 is deferred until 31 January 2021.
- Beyond this, use your cash flow modelling to assess whether you need to apply for a formal 'time to pay' arrangement with HMRC.

So, after taking all these steps, what should you do if your modelling shows you exceeding your existing loan facilities over the next 12 months?

- Talk to your bank: not only will they be expecting to hear from you, they will be able to offer advice, additional short-term funding, and, potentially, access to the government's Coronavirus Business Interruption Loan Scheme, if your recovery plan is SMART (specific, measurable, attainable, relevant and time bound) with stress tested cash flows.
- 'Right-size' the firm.
- Consider your regulatory obligations to the SRA and take advice.

Peter Scott is joint author with Andy Poole of the Law Society's Financial Stability Toolkit.