

COVID-19 pandemic – survival steps

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Cash Management and Stress Testing

The full force of the COVID-19 pandemic is now hitting the UK with most businesses either completely shut down or working well below capacity. Most law firms are in the latter category. The key challenge for managing partners, after ensuring the safety and well-being of staff, is to ensure the firm survives this hiatus, which couldn't have come at a worse time with most firms year-ends fast approaching.

They need to ensure their firm's cash flow is secure, that they stay within their credit facilities, and that the firm is 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.”

Firms should prioritise the collection and conservation of cash

However, this can only effectively be done against the backdrop of an up to date cash flow forecast which is regularly **stress-tested** for a number of different scenarios, including the loss of significant time recording at least over the next three months, a dearth of new client instructions and clients, similarly, experiencing severe financial pressures, either unable to settle bills or 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 this provided when discussing firms next steps and its provision increases the credibility of the financial management of the firm - which is crucial if further facilities are required.

We can help you to undertake this stress testing using models we have developed.

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

Collect cash

- Review every single existing 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 the bill is paid in the very near future. The devil here is very much in the detail
- Bill all existing work in progress (fees and disbursements) as soon as it becomes practical and in accordance with the firm's terms and conditions (often terms and conditions specify monthly billing, which isn't always actioned). Again, particular attention needs to be given to any work in progress balance unbilled for two months, where managing partners need to agree a specific billing plan with the relevant lawyer
- Set 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, no if's or but's, and increase 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, repay capital under the maximum length of time permitted by the Partnership Agreement. It is worth revisiting the detailed terms of the Partnership Agreement to identify which levers the leadership team can use
- Seek reduced working commitments from staff, ensuring you maximise the benefit of the government's Coronavirus Job Retention Scheme, where appropriate
- Stop any discretionary expenditure, stop any investment expenditure, renegotiate leases and other contracts
- Take advantage of any 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

We have a more detailed checklist of actions which we're happy to forward to you on request.

What to do if your modelling, after taking all these steps, 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
- **Review alternative funding arrangements:** this could include more partner capital, private equity (where we have contacts looking to invest) and bond issuance to high net worth investors
- **“Right-size”** the firm
- **Consider your regulatory obligations to the SRA and take advice**
- **Talk to us:** we have experience in helping law firms to get to the best out-come

This note was authored jointly by Paul Browne, Peter Scott and Karl Wingfield.

We are experienced managers and advisors of law firms and together we can help you implement a specific action plan to collect cash, identify the most appropriate steps to conserve cash in the short term and equip you with appropriately stress-tested forecasts to enable you to engage confidently with your bank and other funders.

Call or email one of us to discuss how we may be able to help.

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