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FINANCIAL FACTORS FOR COFAS

In June 2010, the SRA was shocked to discover that Halliwells was on the brink of administration. The firm had some 700 fee-earners, including 114 partners, and offices in Manchester, Liverpool, Sheffield and London. A drop in turnover and high property costs were said to have contributed to the firm's failure.

The SRA was in daily contact with the firm and was making preparations to intervene, depending on the outcome of negotiations with potential acquirers. In the event the firm was acquired by various firms and a potential disaster for employees and clients was averted.

In this challenging economic climate, the SRA remains on red alert to the prospect of a similar financial failure. The spectre of Halliwells is always on its mind.

Under the 2011 Code, there is greater responsibility on firms to self report financial difficulties. The duty is likely to fall to the newly appointed COFAs though this is not explicitly stated in the SRA Authorisation Rules governing the appointment of the compliance officers. Under Outcome 10.3, firms are required to notify the SRA promptly about any material changes including *"serious financial difficulty"*.

Indicative behaviour 10.2 requires firms to actively monitor their financial stability and viability in order to identify and mitigate any risks to the public. Firms have to notify the SRA promptly (IB 10.3) of any indicators of serious financial difficulty, such as inability to pay professional indemnity insurance premiums, rent, or salaries or if it is in breach of bank covenants. Firms must also (IB 10.4) notify if the business may not be financially viable to continue trading as a going concern - for example, because of difficult trading conditions, poor cash flow, increasing overheads, loss of managers or employees and/or loss of sources of revenue

Once a firm has self reported financial problems the SRA will be likely to undertake a Financial Stability Review. A Relationship Manager will visit the firm and review the management accounts and other financial information to assess the viability of the practice. Sometimes the Relationship Manager is accompanied by a Forensic Investigation Officer from the SRA. It is, however, a difficult task to investigate and then form an expert view of the financial health of the practice during a half day visit. All that the SRA can hope to discover is the state of the office bank account and the attitude of the firm's bankers. Following the Financial Stability Review, firms are required to report regularly - often weekly - to the SRA on financial matters. The aim is for the SRA to be kept informed of developments so it is not taken by surprise as in the case of Halliwells.

With the support of its bankers, a firm should be able to trade through their rough times, but without it the firm will almost certainly fail. Many bankers are waking up to the fact that there is no capital value in a law firm and that the legal services market is no longer the cosy monopoly it once was. This adds closer scrutiny to the relationship between firms and their bankers. The SRA adds another level of supervision but it is - I would venture to suggest - supervision without effective assistance. Realistically, the SRA can do very little to help a firm to survive. Whether the SRA will refuse to grant recognition to a firm which is suffering financially in the future is as yet unclear but must be seen as a possibility.

An anonymous blogger at the time said of Halliwells:

It's a shame a lot of these firms only ever give out their turnover and pep numbers. I would suggest a more suitable number to be comparing is their cash and overdraft numbers. We have seen with Halliwells that you can have all the turnover numbers you want, but if you ain't got the cash it doesn't mean anything. Is there no place in the upcoming lawyer 200 survey where they can mention cold hard cash?

A firm's key relationships in trying times are with its cash reserves and with its bank – a truism never to be forgotten. ■