



Face Facts

Legal

MacIntyre Hudson LLP's Legal Sector publication for UK solicitors and law firms



Goodwill valuations – assessing your worth



'Goodwill' is defined as the benefit of the good name, reputation and connections of a business. In other words, would clients continue to work with a firm even when the original partners or name have gone?

In the current economic climate when many firms are looking at acquisitions and mergers in order to survive, their relative commercial value needs to be assessed in order to guarantee a fair goodwill price.

The traditional definition of goodwill recognises that there is a normal rate of return, the so called 'economic rate of return', that can be earned on assets of

a certain type. Where a business earns a profit above this 'normal rate', it is assumed a willing purchaser would pay not only for the underlying assets of the business, but also the right to the 'super profits'. A number of years of 'super profits' is calculated to derive a value for goodwill.

However, there are practical difficulties. Where a business relies on key partners and employees, it is usual for a purchaser to insist on service contracts to ensure their loyalty. Partners are usually stakeholders and it is in their interest to enter into a commercial service contract. However, key employees who are not stakeholders may well insist on a substantially higher level of remuneration. This would typically depress the future maintainable profit and thereby the goodwill valuation. The assessment of a

'normal commercial salary' for a partner's future input often requires careful consideration.

Cameron Cook, Principal in High Wycombe, explains the process of assessing a basis of goodwill:

"We approach an 'arms length' evaluation of goodwill as if it were a deemed disposal. This means that we take a commercial view of such factors as the economic market place in which the business trades; the availability of similar businesses for sale, the market values obtained from similar business sales, and the availability of a willing buyer; as well as the level of maintainable profits which a willing buyer considers the business able to generate in the future."

Where a valuation of a business is required on the assumption of an 'arm's length market value', the level of maintainable profits would influence a buyer as well as the underlying net assets to be acquired. A valuation of goodwill represents the value of the business in excess of net assets which would be purchased by a willing buyer.

We can offer advice on goodwill valuations as part of your strategic planning. Please contact your local office.

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Unlocking your lock up

With many firms struggling in the current economic climate, ensuring that you are on top of your billing could mean the difference between your success or failure.

However, ensuring that every file in your firm's cabinet gets invoiced and that bills go out on the due date at the right rate takes time that you may not have. The solution - that enables partners to concentrate on their fee-earning work rather than spending time billing - may be in engaging a costs draftsman.

Michael Kain, Chairman of Kain Knight, says: "Cost draftsmen are trained in realising and raising correct bills. We have an independent perspective which helps to ensure that bills are for the correct amount. Typically a proficient cost draftsman will pick up 10-15% of missed work or time that is properly billable - which is justification in itself in these cost saving times."

For further information, please contact Michael Kain on 01279 755552 or email michael.kain@kain-knight.co.uk



50% income tax rate update

Currently the top rate of income tax is 40%, but this will increase to 50% from 6 April 2010. An opportunity presents itself to extract taxable income or to accelerate taxable income into the current 2009/10 tax year and pay tax at 40% this year rather than 50% next year, or say the year after. There is a time value cost in paying the tax early but this must

be weighed against the 10% saving in the tax rate. The acceleration could be investment income (such as dividends), salary or both. In the case of salary income, the acceleration will also save on any future increases in National Insurance Contributions.

For further information please contact your local office.

"Many mergers fail to produce the benefits expected at their inception. Mergers are a delicate process and demand very careful attention to detail..."

Making a merger work

With a recent survey* showing as many as six out of ten law firms considering an acquisition or merger, and the Law Society's Law Management section producing a 'Merger, Acquisition and Organic Growth Toolkit', mergers are definitely 'flavour of the month'.

However, experience shows that many mergers fail to produce the benefits expected at their inception.

"Mergers are a delicate process and demand very careful attention to detail as well as a clear strategy", says Grant Gleghorn, Head of the Legal Sector Group.

So how can you make a merger succeed?

Define the aims in advance

These should be documented at the outset and stand up to critical examination from both firms.

Establish a steering committee

Include members from both firms who can devise a streamlined and effective management structure for the new firm, taking into account the pool of skills available. Many professional practices have too many people involved in the decision making process. A streamlined structure frees up valuable time that could be dedicated to fee-generating work.

Cut the right costs

A thorough understanding of the functions in the firm and an

awareness of the knowledge, skills and expertise available is essential in order to retain the staff who add most value to the organisation.

Simplify the business process

This can deliver real cost savings. For example, if you can reduce the number of precedent documents covering a single process, you will save costs (especially training costs).

Get the detail right

This is especially important with the capital structure of the firm and the respective tax positions of the merging firms and the partners. It is also crucial for the practicalities of the partnership agreement or other documents governing the internal relations of the firm. Partner retirement arrangements should be carefully considered, especially in the common situation in which there is 'age bunching' of the partners who own the majority of the equity in the firm.

Manage expectations

It is crucial to ensure that you manage people's expectations throughout the merger process. The ultimate success of any merger lies in the willingness and ability of employees to adapt to the change and fit into the new company culture.

For more information on mergers, please contact your local office.

*survey undertaken by 360 Legal Group



Accelerating your UITF40 tax charge

Owners of professional practices will recall the 2005 change of UITF40, whereby work-in-progress in accounts had to be valued at selling prices rather than at the cost prices.

Mike Hayes, Tax Principal in Milton Keynes, explains: "The change was introduced for the first accounting period ending after 22 June 2005 and created a one-off increase in profits (the 'adjustment amount') for that year, with those profits then becoming liable to income tax. The Government introduced provisions for the adjustment amount to be spread over three to six years which, for many firms, improved cash flow."

However, the rules also allow for a firm to volunteer to accelerate the tax charge and bring forward some or all of the untaxed balance.

Benefits

"In the current economic climate, this could be of benefit if firms are facing falling profits as well as the promised 50% income tax rate from 6 April 2010" suggests Mike.

"If a professional practice that is an LLP makes its accounts up to 30 April each year, the first year for the adjustment charge would be the year ended 30 April 2006, taxable in 2006/07. If the spreading is eligible to extend

beyond the three years, it could include the current tax year (2009/10) and even the two following years. If the Partners are likely to pay tax at the new 50% rate in either or both 2010/11 or 2011/12, it may be beneficial to accelerate the tax charge so that it falls in 2008/09 or 2009/10.

In addition, there are new limits for higher rate tax relief on pension contributions where taxable income is more than £150,000. Accelerating the charge could be of advantage if it means that more income falls in a year where the £150,000 has not been reached, and it is taken out of a year where that limit is exceeded."

Obviously this may not be appropriate in all cases. To see if you could benefit, please contact your local office.



Helping you improve business performance

MacIntyre Hudson's Business Strategy Group works closely with business owners, partners and senior employees, to help develop ways of boosting profitability and business growth. In recent months we have worked with many firms to ensure they are doing all they can to survive the economic downturn and are able to take advantage of new opportunities that arise.

£1,000 to improve your business

Did you know that Government funding is available for business leaders to improve the performance of their organisations?

The 'Leaders First' scheme from the Learning and Skills Council (LSC) gives directors and senior managers funding of up to £1,000 to develop valuable strategic skills to drive their organisation forward.

An initial grant of £500 is available, and a further £500 if the company is willing to match this extra contribution.

Business, public sector and charitable organisations with between 5 to 249 employees are eligible to apply. The candidates must be able to demonstrate that they are key strategic decision makers in the business.

Specialist knowledge

The grant can be used with a number of different training organisations and course subjects. It can also be used against our specialist Business Strategy Group sessions that are tailored around you and your business. We ask you "where you want to be" and show you how you can get there, helping you achieve your business and personal goals.

For more information, or to organise a free taster session please contact Chris Stratton on 020 8446 0922 or email strategicplanning@mhllp.co.uk

"In the current economic climate, (accelerating the UITF40 tax charge) could be of benefit if firms are facing falling profits..."

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Contingent fees – clarification



In July 2008 the Accounting Standards Board (ASB) issued a statement in response to enquiries made regarding the uncertainty of accounting for the costs related to contingent fee arrangements.

Contingent fee arrangements were defined as those where the fee is payable on the outcome

of a future event (e.g. no win no fee). The ASB confirmed that the resolution of a contingent fee arrangement during the post balance sheet period is an event that occurs after the balance sheet date and is a 'non-adjusting event'. Therefore, the position at the year end for an incomplete contract with a contingent fee arrangement should not be amended for a resolution following the year end.

Accounting treatments

In May 2009 the ASB wrote to the Institute of Chartered Accountants in England and Wales (ICAEW) noting that two accounting treatments had evolved for these types of fee arrangements:

- Expensing the costs as they are incurred, or
- Recording the costs as work in progress at the period end.

The ASB confirmed that either approach is acceptable and professional judgement should be used. The requirements of Financial Reporting Standard 18 (FRS 18) must also be considered where accounting policies should be relevant, reliable, comparable and understandable.

Discussions are currently underway regarding the convergence of UK and international financial reporting

standards, including the review of revenue recognition. Until the completion of these discussions the position in the UK is unlikely to change.

From a practical viewpoint this clarification by the ASB removes the uncertainty that has existed over the last few years. It will hopefully also help to conclude the enquiries by HM Revenue and Customs into this aspect of the tax returns.

Please contact your local office for advice on which accounting policy to use and to ensure it is disclosed appropriately.

How to contact us

MacIntyre Hudson LLP has 9 offices across the UK. We are also a member of CPA Associates International, with representative firms worldwide.

See www.cpaai.com for more details.

Bedford

Atul Kariya
atul.kariya@mhllp.co.uk
Tel: 01 234 268 761

Chelmsford

Susan Oliver
susan.oliver@mhllp.co.uk
Tel: 01 245 353 177

email: info@mhllp.co.uk

High Wycombe

Patrick Byrne
patrick.byrne@mhllp.co.uk
Tel: 01 494 441 226

Kate Arnott

kate.arnott@mhllp.co.uk
Tel: 01 494 441 226

Leicester

Ian Betteridge
ian.betteridge@mhllp.co.uk
Tel: 01 16 289 4289

London City

Andrew Burnham
andrew.burnham@mhllp.co.uk
Tel: 020 7429 4100

Graeme Young

graeme.young@mhllp.co.uk
Tel: 020 7429 4100

web: www.macintyrehudson.co.uk

London North

Grant Gleghorn
grant.gleghorn@mhllp.co.uk
Tel: 020 8446 0922

Harmy Gill

harmy.gill@mhllp.co.uk
Tel: 020 8446 0922

Milton Keynes

Mike Hayes
mike.hayes@mhllp.co.uk
Tel: 01 908 662 255

Silvia Vitiello

silvia.vitiello@mhllp.co.uk
Tel: 01 908 662 255

Northampton

Adam Young
adam.young@mhllp.co.uk
Tel: 01 604 624 011

Peterborough

Stuart Manning
stuart.manning@mhllp.co.uk
Tel: 01 733 568 491

MacIntyre Hudson

Corporate Finance Limited
Laurence Whitehead
laurence.whitehead@mhllp.co.uk
Tel: 01 908 662 255

MacIntyre Hudson

Advisory Services Limited
Finance, training & consultancy
mhasinfo@mhllp.co.uk
Tel: 020 7429 4100

If you would like to contribute an article to Face Facts Legal, please contact:

Tina Singh
tina.singh@mhllp.co.uk
Tel: 020 8446 0922

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