AUTUMN 2024

the law

Working with The Law Society

Armstrong Watson's specialist publication for the legal profession

IN THIS EDITION...

DON'T LEAVE THE SUCCESSION OF YOUR MANAGING PARTNER TO CHANCE ...IT COULD DAMAGE YOUR BUSINESS!

INITIAL CONSIDERATIONS FOR LAW FIRM CLOSURE, SALE OR MERGER

STEPS TO TAKE WHEN A LAW FIRM CANNOT AVOID INSOLVENCY

MANAGING FINANCIAL PERFORMANCE: LAW FIRMS

HOW CAN LAW FIRMS GENERATE MEANINGFUL AND USEABLE MANAGEMENT INFORMATION?

10 STEPS TO MAKE THE AUDIT PROCESS EASIER FOR LAW FIRMS

PLUS...

AN INTERVIEW WITH...

CHRIS HANNETT, CYMPLIFY

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WELCOME

Welcome to the Autumn 2024 edition of The LAW, the specialist publication for the legal profession from the legal sector team at Armstrong Watson.

This edition very much has the feel of planning for the future. It includes articles on managing partner succession, client preparation when merging or selling your firm and how to get the most out of your management information to make informed business decisions.

We also look at:

- managing financial performance
- steps to make your audit process more efficient
- what happens when a law firm cannot avoid insolvency

Finally, we feature an interview with Chris Hannett, of Cymplify, on the very important topic of cyber security.

Our specialists are available from all of our 19 offices, to provide proactive support and advice to lawyers in compliance and business improvement matters. This publication is designed to allow us to share our collective experience in acting for lawyers throughout the UK.

To find out more on any of the above, including how we can work with you to help you and your clients, please do get in touch with me.

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DON'T LEAVE THE SUCCESSION OF YOUR MANAGING PARTNER TO CHANCE...IT COULD DAMAGE YOUR BUSINESS!

Whether you are a national practice or a small local firm, one of the key decisions that must be made will be the succession of the managing partner. It is 100% certain that this will happen at some point if the firm is to continue ... it's just a matter of when and to whom!

The sooner a law firm plans for this, the easier the transition should be. So, when should discussions in the firm take place? ... as soon as possible.

Some firms have a retirement date in their constitution. This can make the planning easier as it forces the discussion and the inevitable debate to happen. Often the larger firms have a set period for the managing partner to be in post, say three to five years. This can also make planning easier, if only because it sets the clock running towards a point in time, but of course it begs questions about what the outgoing managing partner will do after their term has ended.

Larger firms often have a process outlined for the succession of the managing partner. If there is no process in place, then introducing one can smooth the process. Perhaps forming a small working party of partners to consider the potential candidates from within could help?

In smaller firms, little consideration is often given to what happens when the managing partner seeks to retire. Early discussion with other partners in the firm should be encouraged, setting out a clear timeline and what should be expected of the successor. As above it's possible that a small group of partners could be formed specifically with a view to making recommendations for the successor. A shadow programme can often work well leading up to the succession date, and potentially also afterwards with the former managing partner staying on in a mentoring role. It can make it much easier if the incoming managing partner has had experience of running the practice, either as number two, COO or as a board member. If the likely candidate is not in one of those positions, it is worth considering doing so in the year or two leading up to a decision to enable them to upskill and also for both the candidate and the rest of the partners to see whether it is likely to work out with them at the helm.

What if there is no readily identifiable successor or the business is a sole practitioner? The managing partner should be able to recognise this and may wish to seek a sale or merger. Planning for this is crucial in ensuring the best possible outcome for the retiree and the ongoing firm.

The main aspect of all of the above is ***early planning and discussion.*** Without this, the potential successors may not wait and could choose to look elsewhere to further their career, potentially causing damage to the practice they will have helped to build and to those left behind.

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INITIAL CONSIDERATIONS FOR LAW FIRM CLOSURE, SALE OR MERGER PART 3

PREPARE FOR CLIENT TRANSITION

This is the third part of our published article in Practical Law, the full article can be found at www.practicallaw.com

Informing clients of sale or merger

Once the sale or merger is formally agreed, the firm is required to inform its clients of its closure so that they can make informed decisions about what will happen to their files and data, and whether they wish the acquiring firm to continue acting for them.

- Set a policy for which clients will be contacted to inform them of the sale or merger. It is good practice to inform both current and former clients. However, the numbers of former clients can make informing all past clients impractical, and the firm may therefore wish to set a limit on which past clients will be contacted.
- Remain mindful that it is entirely up to the client who they choose to represent them. Clients should be given sufficient time and information to make informed decisions about whether they wish to remain with the business after the acquisition, and should be reassured that they retain that choice at all times, including after completion of the sale.

Plan when to inform clients

The firm should be aware that the guidance from the SRA is that clients should be provided with as much notice of the closure (on sale or merger) as possible (see SRA: Guidance: Closing down your practice).

However, it is often difficult to provide advance notification to clients because of the confidential nature of the sale or merger discussions, and it is therefore common practice for firms to inform the clients at the point of completing the transaction.

Many clients will respond promptly with their preferences. However, The Law Society practice note suggests that lack of client responses after a set deadline can be deemed as approval to transfer the client's files to the acquiring firm (see Law Society: Closing down your practice: regulatory requirements).

Manage significant clients

From a commercial perspective, it will be especially important to look after the firm's most significant clients (that is, those that provide repeat business and generate the most significant fee income for the firm) to maximise the likelihood of them continuing to instruct the firm after completion. It is therefore common for them to be discretely informed of the potential sale or merger some time before completion.

Key clients tend to respond well to being given advance notice, especially where their views are requested. This can help you to obtain vital information about what the client's intentions will be after completion and make it more likely that they will remain with the firm after acquisition.

...continued

Manage client conflicts of interests and duties

The parties should make checks to ascertain whether any client conflicts of interest or duties will arise once the firms' client bases are amalgamated into one at completion. This will inevitably involve sharing some confidential client information between the parties before merger.

Maintain client confidentiality

- Client confidentiality must be protected before, during and after the sale or merger. The firm should take extreme care to ensure confidentiality is preserved when sharing any confidential client information between the parties for due diligence purposes.
- Check whether the firm's standard client terms of business expressly provide for disclosure of confidential client information to other regulated entities as part of sale or merger due diligence. If this term is a new addition to the standard terms, the firm should be mindful that it would only apply to clients who instructed the firm after its insertion (that is, who instructed the firm on the new version of the standard terms).
- If the terms of business do not assist, consider how the firm can achieve the due diligence purposes without prejudicing confidentiality. Measures may include:
    1. redacting client files or records before providing them in response to any due diligence request; or
    2. using an NDA. However, be mindful that the SRA has published important guidance on the use of NDAs by law firms and ensure that any NDA prepared for the transaction complies with it (see SRA: Warning notice: Use of non-disclosure agreements and SRA: NDA warning notice (Updated August 2024)).

Plan who to conflict check

Best practice is to undertake checks against the entire client base of the selling firm. However, many acquiring firms consider this impractical because of the numbers involved, and it is therefore common practice to check the parties' top 100 or top 50 or so clients (by costs generated) before completion to be able to address these immediately, and undertake the balance of the checks in slower time after completion, addressing any conflicts as they are identified.

For guidance on issues to consider when running a conflict check, see Practice note, Planning a conflict check: quick guide.

Address any conflicts arising

Consider how best to approach any conflicts that are identified within rules 6.1 to 6.5 of both the SRA Code of Conduct for Individuals and SRA Code of Conduct for Firms. If the merged firm would find itself acting on both sides of a transaction after completion, for example, it may be that one or even both firms need to inform their clients before completion that they will no longer be able to act.

For guidance on analysing a potential conflict situation, see Flowchart, Client conflicts of interests and duties decision tree.

Client money and accountant's reports

Prepare to transition client money

- Any monies the firm holds in any client account must be dealt with in accordance with rule 2.5 of the SRA Accounts Rules. Usually in a sale or merger all client money is transferred to the acquiring firm, along with all client ledger balances and transaction histories.
- When a firm closes without a sale or merger (that is, if the client money cannot be transferred to a single acquiring law firm), client money will need to be returned promptly to each client or transferred to each of the new law firms that their matters are moving to after closure.

Manage residual client balances

For clients that cannot be traced, the residual balance requirements of the SRA Accounts Rules should continue to be followed, including self-certifying payments to charity where appropriate (see SRA: The prescribed circumstances in which you can withdraw client money from client account to pay to a charity of your choice and SRA: Granting authority to withdraw residual client balances).

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Obtain accountant's reports

- Unless exempt from the requirements to obtain an accountant's report, the firm should continue to obtain such reports until it ceases to hold client money (see SRA: Guidance: Accountant's report and the exemption to obtain one).
- The firm should notify the SRA when it ceases to hold client money and, in most cases, the firm will no longer need to obtain a "cease to hold" accountant's report (see SRA: Guidance: Closing down your practice).

Client files and data

- The firm's obligations to safeguard and protect client files and data are not diminished by sale or merger. The firm should therefore work with the acquirer to make detailed plans for what will happen to client information. Options to consider include:
    1. returning material to the client, particularly if the client will not be instructing the business going forward;
    2. arranging for another firm to take over storage of the information, for example, if the client will be instructing that alternative firm after completion;
    3. securely destroying material that has passed its retention period, according to the firm's file retention policy and routine data destruction program; and
    4. scanning and storing the material in electronic form, if appropriate (and where the retention of original documents is not important) and more cost efficient than physical storage.
- The firm will need to ensure that client information remains confidential at all times and that such information remains accessible to those that are permitted to access it (for example, clients and their personal representatives).
- Arranging compliant storage and access of historical client files and information can be costly and time consuming, such that potential acquirers are frequently reluctant to take on the cost and responsibility. The firm should therefore discuss the issue with potential acquirers early on in the sale or merger discussions, so that the firm has plenty of time to make arrangements for any material that will not transfer to the acquirer.
- The firm should inform the SRA how any such material will be stored and how it can be accessed in future by those who are entitled to it.

Undertakings

After completion the merged firm will be responsible for any outstanding undertakings that the selling firm gave before acquisition, unless released from the undertaking by the recipient.

The merged firm will also want to ensure it has the benefit of any undertakings the selling firm received from others before merger.

In the run up to completion the firm should therefore:

- Review its central undertaking register and consider whether any of the undertakings can be discharged, or released by the recipient, before completion.
- If not, the firm should liaise with the acquirer, and the recipient of any undertakings, to agree and formalise the status of the undertaking after completion.
- Contact any other firms that have given undertakings to the firm, to confirm that the benefit of the undertaking will pass to the merged firm (assuming the client continues to instruct the merged firm; see Informing clients of sale or merger).

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Contact Andy Poole if you would like assistance with any of the topics raised in this series of articles.

ANDY POOLE
LEGAL SECTOR PARTNER

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STEPS TO TAKE WHEN A LAW FIRM CANNOT AVOID INSOLVENCY

Several issues can lead to a law firm's financial instability, and in some cases, actions can be taken to improve performance. However, sometimes a firm's debt is just too large to make survival possible.

What are the next steps?

Internal financial audit

Hopefully, a firm's Compliance Officer for Finance and Administration (COFA) will have carried out an internal financial audit. This in-depth examination will ensure that all aspects of the firm's financial performance have been checked to confirm whether the business's continuation, in its present form, is sustainable.

Seek professional advice

It is vital that all key issues are identified as soon as possible. You may have never encountered these problems before so it is useful to speak to an adviser who is experienced in these matters. It may be that you can pursue options such as merging with another firm or seeking a buyer for your business. The right adviser will have a database of firms looking to expand and can ensure a quick sale. It is important that matters are considered, such as property leases where personal guarantees have been given, overdrawn capital accounts, or professional indemnity insurance obligations.

Contact the Solicitors Regulation Authority (SRA)

You must notify the SRA promptly of any indicators of serious financial difficulty relating to your firm, if you intend to cease operating as a legal business, or if a relevant insolvency event, such as a winding up, or an administration order is about to be made against your firm. The SRA's duty is to protect the public so its priority will be to ensure the safety of client monies and records.

Prompt actions and continued updates are appreciated by the SRA, which will also help to avoid interventions.

Ensure proper closure

If a buyer can be found then client monies and files will likely be transferred to the new firm as part of the transaction. If a sale cannot be concluded then it is very important that the business owners work with the SRA to ensure that all relevant matters such as returning client records, and returning monies held on behalf of clients, are dealt with correctly. Effective communication with clients is vital so that they understand what is happening and how their assets will be protected.

Act promptly to avoid intervention

It is important to address the issues arising from a firm's financial distress as soon as possible. It may be possible to extend the firm's line of credit temporarily to buy sufficient time to sell the business. Business owners can be proactive in speeding up the conversion of work in progress to debtors and then cash.

Intervention by the SRA should be avoided at all costs for the following reasons:

- Operational disruption - If an intervention occurs, the firm's operations will cease. The SRA will appoint a specialist intervention agent to protect and then pass on client files and monies to other firms that will continue to act for the clients. This can happen at very short notice, meaning that income that may have been expected in the coming days/ weeks may not accrue.

- Financial consequences - The SRA has the authority to recover costs from the intervened party to cover the expenses incurred during the period of intervention. This can include the costs of appointing an agent to carry out the intervention and managing the practice's documents. These costs can be crippling.

- Personal reputation -Intervention by the SRA can destroy the professional reputation of a practice and its partners, making it very difficult to continue as a solicitor. At the very least, there are likely to be restrictions placed on the practising certificates of those involved.

Early awareness of financial difficulties is essential. Obtaining the correct professional advice can ensure that the best outcomes are achieved, without incurring the financial and reputational cost of intervention.

If you would like advice and support please get in touch with us.

Call 0808 144 54575 or email us at help@armstrongwatson.co.uk to speak to a member of our team.

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MANAGING FINANCIAL PERFORMANCE: LAW FIRMS

This is the fourth and final part of our published article in Practical Law. The full article can be found at www.practicallaw.com and the first three parts of the article can be found in previous editions of The LAW.

Financial compliance

This note covers financial performance, rather than compliance. However, there are a multitude of obligations placed on any business owners, including law firms.

Compliance: HMRC, Companies House and the SRA

Firm owners need to understand that these three agencies are different, and each will have differing requirements. For example, Companies House requires minimal documents per year and there are a variety of reporting exemptions which means that some of the documents filed there can be relatively sparse. However, HMRC requires quarterly VAT returns, monthly pay as you earn (PAYE) reports and annual tax returns: each of which is often detailed down to individual transaction level in some cases. The SRA meanwhile (in financial terms) does not require any documents to be sent to them at all (unless they have specifically requested them). If the firm's reporting accountant has no reportable breaches to note in respect to the firm's annual SRA Accounts Rules review, then the firm does not even need to send that to the SRA.

SRA Accounts Rules: overlap with a firm's financial performance

The area that is more unique to law firms (though there are other sectors which have client money provisions) is the SRA Accounts Rules. Again, this note is not intended to cover them in detail but clearly it is important to not blur the line between money that is the firm's and money that is not. Partially this can be achieved by clear reporting of monies in, frequent reconciliations on cash on hand and a robust policy with respect to both billing and then ultimately dealing with residual balances.

Those firms that are forecasting a cashflow pinch point with many weeks' notice have many more options open to them, compared to those that need to pay the wages tomorrow and do not know how they will afford to do so. It is the latter type of firm that, sadly, has been known to cross the line and dip into the client account to pay the wages. If a firm is already monitoring its financial performance with accuracy and regularity, then there should never a scenario where that is the only option left for the firm.

For checklists to support the COFA and to assist with compliance with the SRA Accounts Rules, see Checklists, Compliance officer for finance and administration (COFA): role and responsibilities and SRA Accounts Rules compliance tests.

Key points for firms

The four parts of this full article series may make it seem like there are a lot of onerous requirements on law firm owners, especially for those SMEs where many of the roles noted are combined into the same person. However, ultimately the firm must monitor three things (assets, profit margins and cash) through a variety of checks that need not take that much time once they are up and running. Moreover, some of this can be outsourced or delegated either internally (to the fee earners themselves) or externally to specialist accountants, software providers or data "dashboards". In all cases the key is to do something.

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HOW CAN LAW FIRMS GENERATE MEANINGFUL AND USEABLE MANAGEMENT INFORMATION?

The golden rule with most things in life, and management information being no exception, is that the quality of what you get out, is only ever as good as the quality you put in.

Improve data quality

The key therefore to good quality record keeping is to have in place sound systems and controls to ensure transactions are recorded accurately, timely and consistently. These systems and controls should be regularly reviewed to check they are relevant and the most efficient way of doing things. This will not only lead to improvements in the quality of the data being entered, it will also help your firm to adapt to change if there are changes in software or staffing, for example.

Once processes are embedded to ensure the data being entered into the accounts software is accurate, timely and consistent then this can be developed further and shift from being basic bookkeeping to more meaningful management accounts preparation. This shift will involve incorporating the typical year end accounts adjustments, and posting these on a monthly or quarterly basis. These adjustments would usually include:

- Identifying prepayments and spreading the cost over the relevant invoiced period
- Identifying accruals and late invoices so that all known costs for the period are included
- Capitalising and depreciating fixed assets in line with policies adopted
- Capitalising and amortising intangible assets in line with policies adopted
- Calculating recoverable WIP each reporting date
- Reviewing the office ledger for any potential bad debts and including a provision for these

Make informed business decisions

When a firm has good quality management information (MI) incorporating all of the above adjustments, then they are in a really good place to make informed business decisions, and influence interactions between fee earners and clients. Firms will also have the ability to drill down into the profit and loss and balance sheet in more detail to make comparisons to a previous month's or year's performance, and also the ability to measure and review key performance indicators (KPIs) on an ongoing basis.

Additional tools such as budgeting and forecasting are also fundamental. Budgeting is useful for monitoring overall profitability of a firm, comparing how fee earners are performing against their individual targets and controlling costs, whilst forecasting allows you to consider future cashflow and any pinch points, which helps in making some of the more strategic business decisions.

Furthermore, whether your firm time records will also impact on the KPIs that can be measured and reviewed.

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The more data that is measured, the easier it is to manage and control. However, there is also a risk of information overload and people not having the time or inclination to review the data, and not taking action as a result. It is therefore far more productive to have less information that is targeted so that far more people in the firm receive bespoke MI on a KPI basis that is relevant to their role and work type, within their control and set against realistic bespoke targets. People can then easily make informed decisions and take appropriate action to improve the financial performance of the firm, whilst maintaining excellent relationships with clients.

Top four financial KPIs for law firms to monitor

1. Work in progress days – the length of time between undertaking work on a matter and raising a bill for it
2. Debtor days - the length of time it takes for a firm to collect payment for a bill

These two KPIs combined provide you with the firm's lock up – the lower the number, the quicker it takes a firm to be paid. Focussing on bringing this number down should therefore be a priority.

3. Utilisation rates – the percentage of a fee earners total working hours spent (and recorded) on (presumably billable) client work
4. Recovery rates – the percentage of billable hours that a firm invoices to clients

These latter two KPIs combined provide you with the efficiency of the firm – the higher the number, the more productive staff are. Focussing on pushing this number up should therefore be a priority.

If a firm also reports by work type and/or branches then it should also be possible to calculate these four KPIs to a more detailed level, by person and by work type. This will in turn give more meaningful areas to investigate and improve performance. It will also help to generate specific and appropriate actions from the relevant fee earners that will boost cash flow and profitability.

All of these higher-level reviews can help focus attention on areas of the business where improvements can be made and help to challenge fee earners and management to get the best out of their teams.

Checklist to improve management information

1. Systems and controls are imperative for having accurate, timely and consistent data
2. Monthly adjustments for prepayments, accruals, depreciation, WIP movement etc will improve the quality and reliability of the management information which in turn will lead to more informed business decision making
3. Comparing actual results to previous years and budget (where available) will provide a good insight into which work types are under or over performing and what costs need to be monitored and controlled
4. Updating budgets with actuals, and forecasting ahead will allow consideration of future cashflow and any pinch points giving a clearer picture to allow for strategic business decisions
5. Using the data to calculate KPIs will allow you to monitor performance; this can be drilled down by branch/work type/fee earner as appropriate
6. The more data that is measured, the easier it is to provide challenge and to manage and control outcomes.
7. Reducing volumes of information and switching to lower volumes of relevant KPIs alongside specific targets will be more productive and impactful.

If you would like advice and support to help improve your management information please get in touch with a member of our team. Call 0808 144 5575 or email help@armstrongwatson.co.uk

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10 STEPS TO MAKE THE AUDIT PROCESS EASIER FOR LAW FIRMS

Law firm finance teams will often talk about the challenges that an audit brings. Finance teams have limited capacity to answer questions from auditors whilst performing their routine duties; timelines can slip which can impact routine finance team functions as well as the audit process.

For a first-year audit these challenges can be even greater due to unfamiliarity with the audit process. These challenges can manifest themselves as potential overrun fees, staff stress and delays.

The good news is there are steps that can be taken to make the process as efficient as possible. Whilst the auditor should be providing guidance, there are pre-emptive steps that finance teams can take to make the process more efficient.

1. Review and clarify deliverables lists early

Prior to an audit commencing there will be communication between the finance team and the audit team which will include a list of deliverables. Finance teams should scrutinise this list closely and consider whether they are able to provide the information requested within the timeframe specified. Where clarification needs to be sought this should be obtained in advance. Having these conversations early will save finance teams time and ensure that they are able to provide the correct information the first time.

2. Set reminders to run time-critical reports at year end

Where the list of deliverables contains reports run from the accounting system, finance teams should consider whether any of these reports can only be run at a point in time. Where retrospective reports cannot be run, this can create an avoidable time drain reconciling reports back to the year-end balance.

3. Pre-empt questions and collate supporting evidence for judgements and estimates in the financial statements – particularly Work in Progress (WIP) reports

A significant amount of the information requested will relate to objective items. However, some items will relate to subjective items, where management have made judgements and estimates in the calculation of figures for inclusion in the financial statements. Where such items are present, the auditor will typically want to "get into management's shoes" before reaching their own conclusion. To this extent, consider whether the evidence provided documents management's thought process in sufficient detail. Typically for a law firm, an auditor will want to get comfortable with the WIP provisioning policy. Finance teams should consider whether the evidence supplied tells the auditor why management consider a particular WIP provisioning policy to be appropriate.

4. Make fee earners aware of the timing of audit fieldwork and the importance of providing responses to the auditors

Auditors will want access to fee earners to provide rationale as to why they consider a WIP balance to be recoverable. Finance teams will need to liaise between auditors and fee earners to ensure that the information requested is provided. This can be pre-empted to a certain extent; fee earners can be requested to provide rationale for all WIP balances greater than an agreed threshold on a monthly basis for instance.

5. Ensure that year end WIP and debtors are thoroughly reviewed for recoverability

Where the deliverables relate to more objective areas, finance teams can reduce the number of follow up questions by collating the information to support balance sheet items at the time of preparing the year-end figures. If evidence has been used to calculate say accruals and prepayments at year end, it makes sense to retain this in an easily accessible folder at the time of preparation rather than have to search for the evidence again at the time of the audit.

6. Ensure the finance team know how to access all reports requested by the auditors

Several tests performed by the auditors will start from outside of the accounts system. Sales testing will typically start from timesheets. Do the finance team know how to obtain the information required and can the timesheets be traced to matters by the audit team?

7. Agree the mapping to be applied to the trial balance when preparing the financial statements early

Where the auditors are preparing the financial statements, have management considered how their trial balance will map to the statutory accounts?

8. Consider whether controls can be implemented to track assets

Auditors will typically want to verify fixed assets held by the entity. For some assets, such as vehicles, identification is straightforward. However, for homogenous items such as laptops, has management implemented a method of tracking individual items? Again, this will both enhance the efficiency of the audit process and enable management to safeguard the assets of the entity.

9. Collate relevant legal and financial agreements ready for access

Not all information requested by the auditors directly relates to figures within the trial balance. Auditors will want access to certain legal agreements, for example, leases, finance facilities and partnership agreements. Are these legal agreements readily available?

10. Ensure auditors can access systems remotely and/or have access to desk space in your offices

Finally, the finance team should consider the practicalities of being audited. Does the entity have sufficient space to accommodate the audit team? Are they able to log into the finance and/or practice management system? As auditors move to cloud-based audit packages, internet access is key i.e. are they able to access the firm's wi-fi network? Are all members of the finance team available when the audit is being performed?

Have you done everything you can to prepare for your law firm audit?

Whilst consideration of the above points will help the audit process to go more efficiently, a number of these points will also aid management of the business. Having a documented thought process for WIP provisioning may help management to arrive at a more robust WIP provisioning figure which will enable better decision making. Likewise, making fee earners justify the recoverability of their WIP balances on a regular basis throughout the year will enhance the reliability of the firm's figures throughout the year, identifying potential issues ahead of the year end audit.

Considering the above points will assist the auditors in concluding their procedures on time and reduce the burden on the finance team. Should you have any questions on the issues raised in this article please get in touch:

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AN INTERVIEW WITH...

Andy Poole interviews legal sector cyber security expert, Chris Hannett of Cymplify, to explore his thoughts on what law firms should be focusing on to actively reduce their cyber risk exposure.

1. What is your background in the cyber security industry?

I have worked in all aspects of the cyber security industry for 15 years, with a wide range of enterprise clients - from banks, large retailers and global oil and gas companies to the Ministry of Defence and NATO.

For the last six years, I have been working with the more exposed and less prepared middle market, with a primary focus on legal and professional services sectors. We have a growing number of law firm customers, as well as chambers, alternative legal services and legal consultancy businesses.

I have also been the victim of a cyber attack myself, where cyber criminals managed to steal the majority of our family life savings. As well as the devastating financial impact, there were also other marks left by that incident.

2. What is the prevalence of cyber attacks in the legal sector?

According to research published by the National Cyber Security Centre (NCSC) in 2023:

- 65% of all UK legal firms have experienced some form of cyber incident
- Cyber attacks have grown by more than 60% in the last two years
- The number of Top 100 Law Firms experiencing an attack has risen from 45% in 2018/19 to 73% in the most recent financial year

The legal sector has specific challenges that make it particularly attractive to cyber attackers. In many ways the sector could be considered the perfect target:

- It is a big target – almost 33,000 enterprises employing more than 320,0000 in the wider legal sector, which has a revenue of £44bn in the UK alone
- Vast amounts of sensitive and often highly sensitive financial, business and personal data being handled on a daily basis
- Large amounts of client money held and transacted by law firms
- Any disruption to routine business in terms of lost billable hours has significant implications, and the longer that goes on, the worse it gets
- Your reputation is absolutely vital to your success - any question marks over the integrity or capability of your firm can be devastating
- Many firms do not have in house IT expertise, and often rely on external IT providers to provide the day to day IT operations that keep the firm running
- There is often a misplaced assumption that these external IT providers will provide 'cyber security' as standard because they are the IT function - in reality this is rarely the case unless you have a specific arrangement in place
- Those firms that have internal IT capability tend to have a similar focus on business operations delivery (email, laptops, servers etc) which is obviously important, but does not typically involve any understanding or ability when it comes to cyber risk management
- Time constraints, deadlines and often high pressure situations create very attractive conditions for attackers

In an effort to stem the tide, bodies like the NCSC have updated their guidance and are reinforcing their messaging that cyber risk is a clear and present danger to the legal sector. Although the NCSC's Cyber Threat Report: UK Legal Sector report contains guidelines, a more fundamental ability to actively address the issues is urgently needed.

3. What particular risks do law firms face?

It is clear why an attacker would target a law firm. It is also useful to know how an attacker could carry out an attack.

The most common kind of attack is also one of the worst ones - ransomware.

The initial stage is gained typically by some form of phishing or social engineering technique - which is simply a first tactic to get a person to do something that allows the attackers a first foothold. That might be as simple as clicking a link in an email or carrying out some instructions from a more senior member of the firm asking them to do something that seems to be legitimate.

Then one of two things happens.

1. If you are lucky, the payload (the actual malware / malicious software) is detonated straight away, and all your systems are locked and encrypted. The decryption key to restore access to your systems has a price on it, and you have a time window in which to pay the attackers. This payment can range from a few thousand pounds up to several million.
2. If you are unlucky - and this seems to have become the norm in the last three years or so - you will experience what is now termed double extortion. This is where the attackers gain access to your systems and steal your data as well as then deploying the ransomware. So, as well as being held to ransom they also experience a data breach. The attackers are able to prove they have access to data via a leak site or via private communication with the firm demand even higher payments to provide both the decryption key and to not release the data publicly.

There is a worrying increase in triple extortion recently, where attackers follow the steps of double extortion, but once they have received your payments, then go on to sell your data to the highest bidder anyway - increasing their profits even further.

It is really important to understand that this is just one single scenario - there are so many others that can and do happen.

4. What should law firms be doing?

The most important thing firms can do to reduce their exposure is to be proactive. Be proactive in understanding the risks you face, your actual exposure, the impacts that can happen and plan accordingly. Be proactive in your firm's attitude toward cyber risk - don't just plan for how you will react if it happens, take proactive steps to drastically reduce the risks of this happening in the first place.

90% of successful cyber attacks start with some form of human interaction – so, be proactive in your cyber awareness training at all levels of the firm and the role every single person pays in keeping the firm safe. Implement simple but effective measures like multi-factor authentication (MFA), a solid backup strategy (ideally air-gapped if possible), continuous monitoring and alerting to exposure and carry out penetration testing at least once a year. Review existing business insurance to ascertain what cover if any you would have in the event of a cyber incident, and consider a standalone cyber insurance policy.

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