the law

WINTER 2023/24

Working with The Law Society

Armstrong Watson's specialist publication for the legal profession

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PLUS...

AN INTERVIEW WITH... SIMON LUKE, COUNTRY MANAGER, FIRST AML

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- Business Plans
- Benchmarking
- Mergers & Acquisitions of Law Firms
- Law Firm Valuations
- Forecasts
- Raising Finance
- Lock-up Reviews
- Pro-active Tax Planning
- Tax Compliance
- Audits
- Accounts Rules Reporting
- Accounts Preparation
- LLP conversions
- Incorporations
- ABS Applications

WELCOME

Welcome to the Winter 2023/24 edition of The LAW, the specialist publication for the legal profession from the legal sector team at Armstrong Watson.

As uncertainty remains in the wider economy and the legal sector in particular, this edition of The LAW focuses on helping law firm leaders to assess where their firm is now, and how it might perform in the future.

Subject matter includes:

- Benchmarking – how does your firm compare against your peers
- Valuing your law firm
- Law firms in distress
- Managing lock up

We also include articles on fraud and also common accounting issues for law firms, and an interview with Simon Luke of First AML about making it easier for law firms to onboard clients.

Specialists are available from all of our 16 offices, to provide pro-active 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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BENCHMARKING UPDATE

As an added value part of our compliance service for annual accounts and tax, we supply our law firm clients with a bespoke individual benchmarking report which analyses the results of their firm for the year and also compares their performance against other firms. Our clients find the report immensely useful when discussing their annual accounts, as it allows us to focus more on their strategy looking forwards, rather than the numbers in their historic accounts.

Each year we summarise the results of these practices in our annual benchmarking review. This review covers firms of all sizes, throughout the UK. Where possible the results are analysed by practice size. The practice size is determined in terms of the number of full equity partners within firms, excluding fixed share equity partners and salaried partners. We classify firms with 1-7 full equity partners, as being small and those with 8+ full equity partners as large, in reality, law firms with 8+ full equity are very much at the larger end of the legal market given the demographics of the sector.

The key highlights from our 2021/22 annual review were as follows:

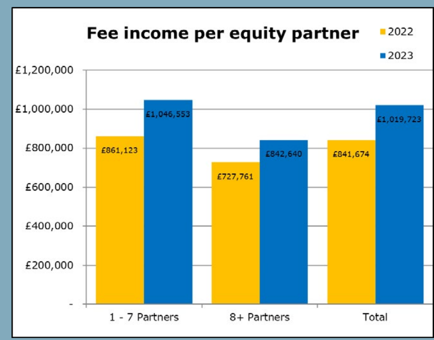
- The average fee income per equity partner was £842,000 which was 10% higher than in 2020/21.
- The average fee income per fee earner was £133,000 which was 5.3% lower than 2020/21.
- The average net profit per equity partner was £199,000 which represented 23% of fee income. This had increased from £185,000 in 2020/21.
- On average there were 5.9 fee earners for every equity partner.

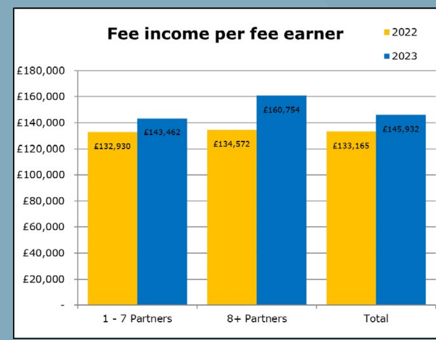
We have now completed a mid-year benchmarking review based on data we have for the year to date, and we have seen the following key trends so far for 2022/23:

Fee income

Fee income per equity partner has increased substantially by 21% from 2021/22. With average fee income per equity partner now at £1.02m, this is the first time that average fee income per partner has surpassed £1m in our benchmarking data. This average fee income rise is most notable in law firms with 1-7 partners with the average fee income per partner of £1,047,000 compared to £861,000 in 2021/22.

Fee income per fee earner has also increased by 10% upon last year. The average fee income per fee earner is now £146,000.

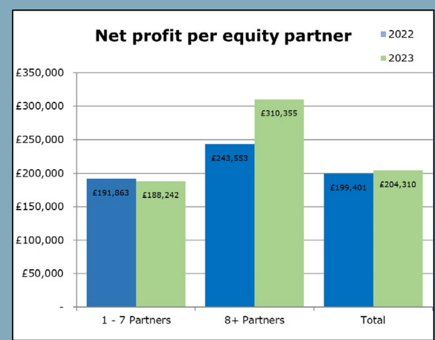


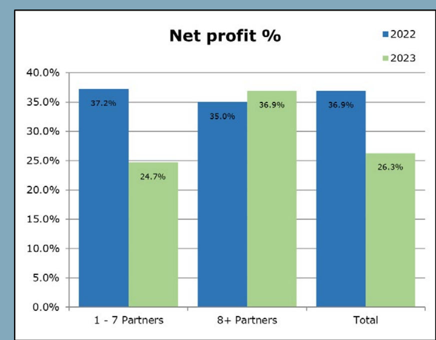


Net profit

Net profit per equity partner is currently £204,000 which remains comparable with the previous year having only increased by £5,000 (2%) from 2021/22. However, there is a widening difference between net profit by partner in the different sized firms. Net profit per equity partner is £188,000 (2021/22 - £192,000) in firms with 1-7 partners compared to a figure of £310,000 (2021/22 - £244,000) in firms with 8+ partners.

Net profit % has overall fallen from 36.9% in 2021/22 to 26.3% for 2022/23. This fall is solely in smaller firms where NP% is down 12.5% to 24.7% compared to larger firms where NP% has increased slightly from 35.0% in 2021/22 to 36.9% in 2022/23.

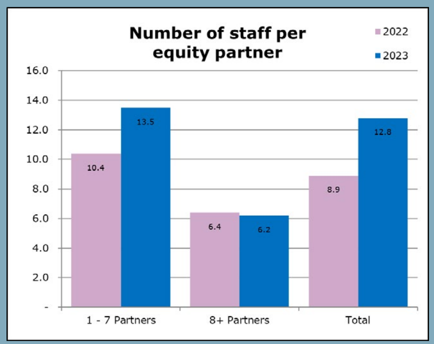


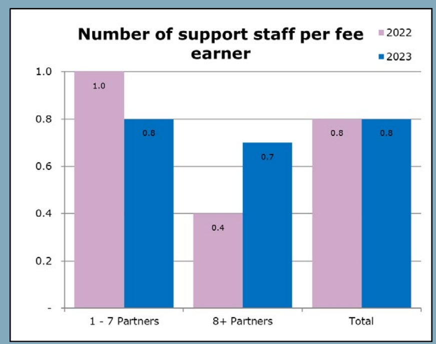


People

On average for 2022/23 there are 6.9 fee earners for every equity partner across all firm sizes. Firms with 1-7 partners show an increase in the ratio from 6.1 to 7.3, but with larger firms (8+ partners) there is a fall from 4.7 to 4.5. The figures continue to show that firms with a smaller number of partners have more fee earners per equity partner compared to the larger firms. This seems a little counter-intuitive, but may be because smaller firms have restricted the number of equity partners to protect profits per partner, and an increasing number of employees not wanting to take on the risk of ownership, particularly in smaller firms. We are also seeing an increasing number of partners leaving larger firms to set up in practice themselves, especially in niche markets. As these firms grow they tend to take on more fee earners to support founding partners rather than add to equity partnership.

Overall staff costs as a percentage of fee income have increased from 39.1% to 41.5% across all firms. The percentage in firms with 1-7 partners has increased from 39.0% in 2021/22 to 42.2% in 2022/23 however percentage costs have fallen slightly in larger firms from 39.5% to 37.4% for the same period. This reduction in staff costs for larger firms won't be driven by falling salaries (quite the reverse!) but rather by increasing fee income. However, the rise in staff costs for smaller practices does follow the trend that we are currently seeing in that firms are having to offer higher market salaries in order to recruit fee earners, whereas larger firms already tend to offer attractive remuneration packages.





Overheads

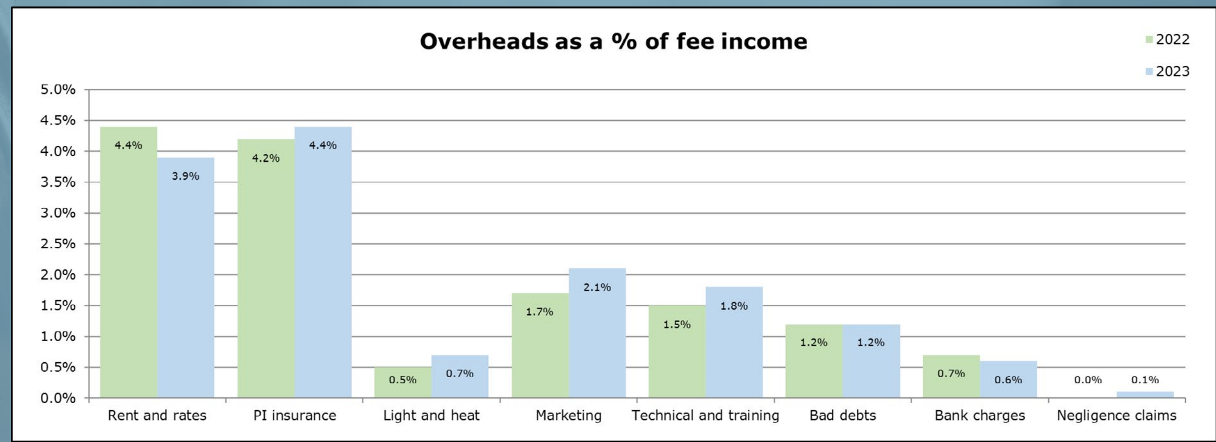
Rent and rates as a % of fee income has decreased from 4.4% in 2021/22 to 3.9% for 2022/23. This again follows the trend for firms to actively reduce office space and in some cases close branch offices as a result of more hybrid and home working.

PI insurance as a % of fee income has seen another rise this year to 4.4% from 4.2% in 2021/22. This follows recent research published by the SRA and Legal Services Board (LSB) which found that the average PII premium for law firms is now equivalent to 5% of a law firm's annual turnover.

However, there is a widening disparity between smaller and larger firms, practices with 1-7 partners on average have PI costs at 4.6% of fee income, with some smaller firms with property exposure having premiums in excess of 10%, but firms with 8+ partners have a much lower percentage of 3.1% for 2022/23 so far.

Marketing spend as a % of fee income has increased from 1.7% in 2021/22 to 2.1% in 2022/23. Marketing events have been restricted in previous years, but this increase shows that firms are now increasing the number of in person events and meetings and trying to move away from the online events that we have become accustomed too lately.

Another key trend to emerge this year is the rise in technical and training costs as a % of fee income as overall this has increased to 1.8% in 2022/23 from 1.5% in 2021/22. These costs tend to include online subscription costs for libraries but also training costs for courses and programmes. We have seen a large shift in firms actively increasing training and development expenditure to invest in employees help with staff retention.



In summary the benchmarking results for 2022/23 to date are highly encouraging with both smaller and larger firms showing strong performance particularly with fee income. Smaller firms are currently being impacted to a greater extent by wider economic pressures such as rising staff and PI costs, so it will be interesting to see how these are controlled and as we move forward.

If you are interested in seeing how your firm compares with the benchmarks in this report or want to further investigate variances with your own firm's performance, then please contact us.

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THE LAW I WINTER 2023/24

HOW MUCH IS MY LAW FIRM WORTH?

One of the biggest questions when you are looking to buy or sell a law firm is what is it worth. Whether it be selling due to retirement or buying a firm with a view to allow you to expand and grow, valuation is often the key point for consideration. Being the Law Society's preferred partner for accountancy and corporate finance services, the legal sector team at Armstrong Watson is well-versed in valuing law firms of all types and sizes, all over the country.

The valuation of a law firm is not an exact science. The actual value can only be determined by marketing the business for sale and then negotiating between a willing buyer and a willing seller. In absence of such procedures, law firms are normally valued using one of three methods:

i. Applying a multiple to maintainable fee income

ii. Applying a multiple to maintainable net profits or earnings

iii. Valuing the net recoverable assets of the practice and determining whether to add an element of goodwill.

Usually, firms tend to be valued at no lower than the value of the net recoverable assets. However, if the business is to cease trading, the valuation would be based on the break-up value of the net assets. On a break-up basis, the net recoverable assets would be lower than on a continuing basis, due to:

- assets that do not realise full value once the business is broken up such as work in progress, unpaid bills, and unbilled disbursements; and
- liabilities for winding up the business such as accounting costs, legal costs, regulatory and redundancy costs, and potentially for involving intervention agents.

Valuation using multiples

The valuation multiple will reflect the valuation of goodwill in the business. Goodwill is mainly driven by having a good name, reputation, and connection of a business. The calculation of goodwill will be the excess in the valuation of the business over the value of the net tangible assets in the business. To obtain an excess, the estimated annual maintainable profits from the business must be greater than a financial return from the investment in the net tangible assets.

In the last two years or so, firms have generally enjoyed particularly large increases in profits and good cash flow, despite a very early slowdown caused by the Covid-19 lockdown. During that period demand for legal services has been high and firms have been more concerned with recruitment and retention in order to meet that demand.

The main issues for law firms right now are the impact of a potential UK recession/slowdown reducing transaction volumes; poor cash flow resulting from increased lock up, particularly if Court redress is required; and increasing interest rates making it more costly to borrow to invest. However, thanks to this latter point, law firms that hold large amounts of client money are benefiting from the increased returns on such balances.

Multiples based on a maintainable fee income have been rarely used in the last few years and are only really used when a firm has large amounts of recurring work and fees. Often brokers may quote multiples of fees as a valuation basis, but in reality when you are buying a firm, it is the right to the future profits of the firm that you are acquiring, and so multiples of profit are the usual real valuation basis in law firm transactions.

The profit/ earnings multiples adopted differ based on a range of factors these being; size; age; reason for the transaction; work type; and who the acquirer is. For the smaller outfits that are looking to exit with no succession plan where all of the goodwill is vested in individuals, multiples may be as low as zero. For larger outfits in stable/mixed work areas and easier succession, multiples tend to range between 2 and 4. For those that are being acquired by the new floated firms, multiples have been in the range of 4 to 7, more commonly around 5 to 6. Private equity backed acquisitions have seen multiples in a larger range but commonly have fallen in a range of 4 to 5.

Once the profit multiple has been decided, it is then necessary to determine which profits to apply that multiple to. This is often achieved by taking a weighted average of the profits earned for the previous three years, with more weight being put on recent years. It is often necessary to adjust the actual profits from the accounting records to reflect 'maintainable' earnings. The adjustments will vary from firm to firm however some typical adjustments are:

- to incorporate a notional partner salary to reflect the cost of employing a fee earner to carry out the fee-earning duties of the partner(s);
- to incorporate a notional rent charge if properties are owned by a connected party and are not shown in the profit and loss account at market rates;
- to remove any exceptional non-recurring items in the profit and loss account;
- to smooth out the effect of any changes in accounting policies; and
- to smooth out the effect of any cultural changes post COVID-19.

Applying the multiple to the maintainable earnings will get you to the Enterprise Value (EqV) of your firm. However, the majority of deals are completed on a cash-free debt-free and normalised working capital basis, and so you would need to adjust the EqV to add cash and cash-like items and deduct any debt and debt-like items, and then adjust for normalised working capital to get you to the Equity Value.

Valuing the net recoverable assets

It may not necessarily follow that the value of the net assets, shown in the accounting records or the accounts of the business as prepared under UK Generally Accepted Accounting Principles ("UK GAAP"), is the reported value. For example, work in progress ("WIP") valued in accordance with Financial Reporting Standard 102 section 23 ("FRS 102") does not necessarily reflect the recoverable sales value of work performed to the balance sheet date of the accounts, particularly for contingent work types. In following UK GAAP, contingent work in progress is most commonly valued at nil or at a cost value rather than the anticipated recoverable value if the contingency were removed. This is important as in firms that specialise in contingent work types off balance sheet WIP can result in the net recoverable assets being higher than the value calculated using a multiple valuation method meaning net recoverable assets will be the most appropriate valuation method.

In order to determine the net recoverable amount of assets, attention would also need to be given to the recoverability of unpaid bills and unbilled disbursements. This would usually be evidenced by the ageing profile since the older the items are, the less likely they are to be collectable. However, in certain work types such as Personal Injury, it is common for the work to take place over a longer period, in excess of a year in many instances, and therefore comparatively older unbilled disbursements may still be considered collectable.

How do I value my law firm?

Overall there are lots of intricacies in every firm which will affect the valuation and the subjective nature of these intricacies shows that one person's valuation of a business may vary from another. It's therefore important that you seek professional advice when trying to value any firm, or decide on potential future strategies. Should you need support in valuing your law firm, or a potential target, please contact the Armstrong Watson team.

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FINANCIAL DISTRESS IN LAW FIRMS

There are several ways a law firm can find itself in financial distress. Knowing how a firm might fail and how this can be avoided will ensure you identify issues and take appropriate action to improve your business's financial performance.

Why are firms failing?

1. Lack of PII cover

This issue continues to be a factor. PII providers have to be mindful of the economic stability of their clients as, where an intervention is made by the Solicitors Regulation Authority (SRA), they are obliged to provide six years of run-off cover, even when premiums are not paid.

Although stablilising a little, insurance premiums have soared during recent years and law firms need to be aware that the size of their firm and the type of work that they undertake can have a big impact on the cost of their PII premiums. The cost of insurance is becoming an increasing problem for smaller law firms which may not have the same risk management processes as large law firms. Those working in the property conveyancing sector have been particularly hard hit by higher premiums because of the perceived risk of high-value transactions, with claims arising from increased mortgage rates and a slump in sales prices.

2. Shrinking of profit margins

A recent survey found that revenue growth in the legal sector last year averaged 8% while salaries in the same period have increased by 10%. Energy costs have also increased exponentially and interest rates are at 15-year high. Firms must react swiftly to adjust charge-out rates in order to maintain profits.

3. Poor cashflow management

The current cost of living pressures is adversely affecting lock-up levels. Effective cash collection is becoming more of a challenge but is vital in maintaining the working capital of a firm. Equity partners must be realistic when setting drawings levels, despite their own financial pressures resulting from high inflation levels.

4. Fraud

Axiom Ince was shut down recently by the regulator, some six weeks after the SRA suspended former managing partner Pragnesh Modhwadia over suspected dishonesty. The firm secured a freezing order for £64m against Modhwadia, and his lawyers confirmed in court that the client account money was gone. It was spent on purchasing and renovating properties and buying the larger firms Ince & Co and Plexus Legal. This failure is not only giving the SRA a huge headache - it could affect every firm in England & Wales as they may all have to make a one-off payment to cover the shortfall in the compensation fund, created by the collapse of Axiom Ince.

5. Cyber risk

Clients trust law firms to safeguard their highly confidential, commercially sensitive, and often personal information. In many areas, legal firms handle large funds on behalf of their clients. This is why cybercrime is such a threat to the legal profession. Phishing is the most common cyber threat. 'Phishing' is when criminals use scam emails, text messages or phone calls to trick their victims. The aim is often to make recipients visit a website, which will then download malware (such as ransomware or a virus) onto your computer, or steal bank details or other personal information, such as login details. Just recently the Information Commissioner's Office reprimanded a County Durham law firm after a cyber-attack led to a data breach and four fraudulent payments being made on a probate matter.

How can these problems be avoided?

1. Know where you are

Having access to accurate and timely financial information has to be a top priority. This will allow you to see which parts of your business are most profitable. In these times of inflation and high interest rates, it is not possible to stand still. Increased costs are inevitable and efficient firms are constantly asking how these costs can be kept under control. Having reliable forecasting tools can assist in developing strategies for the future, allowing you to stress test the effect of changes in working practices.

2. Be brave when looking at charge-out rates

Some consider that maintaining charge-out rates reduces the stress of confronting clients with price rises. In the long run, this approach is unsustainable. A new mindset is required. An increase in charge-out rates gives you an opportunity to communicate with your client. By understanding their needs, you can illustrate how you can help to attain these, shifting the focus from price to clients recognising the value of your services. It gives your fee earners the scope to be creative in dealing with client problems. Their job satisfaction will rise when they receive positive client feedback on a job well done.

3. Keep up to date with technology

Generally, most legal firms will use some sort of case management software. Also, billing and tracking software is commonplace. This ensures that firms are compliant with regulations as well as speeding up the billing process and tracking time spent with clients. This process can be extended to online payment solutions. The right software ensures that clients can quickly and easily pay their bills in the ways that feel most comfortable and secure to them.

Additionally, keeping your firm protected from cybercrime is essential. The National Cyber Security Centre, a part of GCHQ, produced a very useful document in June 2023. This cyber threat report highlights risk areas and gives useful, practical advice on how to protect your firm.

Using AI-based automation tools, legal firms can take repetitive, time-consuming tasks from human employees' hands and turn them over to computer programs. This both eliminates the risk of human error and streamlines workflows that would otherwise eat up a large chunk of a lawyer's daily employment. This technology is in its infancy, and it will be interesting to see how it develops.

If you would like help and support to improve your business's financial performance, or if your business is struggling and you are not sure how to get back on track, please get in touch. Call 0808 144 5575 or email help@armstrongwatson.co.uk

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MANAGE YOUR LOCK-UP... GET YOUR CASH OUT!

Retiring from a professional services firm can happen for a variety of reasons. Being paid out on departure may not always be simple or straight forward and may not be possible in the timescale the retiree hope for - this article explains why.

The vast majority of professional firms are LLPs or traditional partnerships. They require a level of funding to provide working capital for the business.

Funding in professional firms is usually a mix of:

- Traditional bank finance
- Asset based finance
- Partner funding

The levels of the above will depend on the needs of the individual firms.

The amount of partner funding will normally be set by the firm, usually to contribute an amount towards the level of working capital required. At any stage a partner will need to be able to draw an element of profits (usually monthly) to cover living costs and on retirement will need to be confident that the firm can repay the capital account and pay-out any undrawn profits. The extent to which the firm has the ability to do this will be determined, mainly, by the level of lock-up in the business. Lock-up is the term used to describe the value of unbilled work-in-progress and unpaid fees. It is often expressed as a number of days.

An example of how the calculation is made is useful in showing the effect that changes in lock-up can have on the available cash for the business. See below:

Turnover	£7.5m
WIP	£625k
Debtors	£1.25m
Total lock-up	£1.875
Lock-up days	91 days (1.875/7.5 x 365)

Whilst there can always be an argument as to the financing required for lock-up, the fact that WIP and Debtors should include a mark-up, and lock up could be netted against certain creditors, it is true that in this example there is a funding requirement of up to £1.875m for amounts due to the firm at that point.

Using the above example if the lock up was as high as 120 days the lock-up value would be c £2.4m whilst if could be reduced to c60 days the value would fall to c £1.2m ... a movement of one day in accounts for around £20k in potentially available cash or c £140k for a movement of lock-up by one week. In the example given... reducing the lock-up by say two weeks could free up c £280k of cash - perhaps enough to help towards a timely pay-out of capital?

The numbers here illustrate the effect of strong lock-up management, and for retiring partners to be aware of the effect of lock-up movement on the potential for releasing cash to them. Simplistically the higher the level of lock-up the more cash (capital) is required by the business, and the less is available for pay-out.

Some firms will run by partner portfolio and some by department and so may have differing ways of managing their lock-up. The overarching principle however is that the lower the level of lock-up the more cash available to the business for future planning including paying out retiring partners!

Partners need to be thinking at all times about lock-up management ... not just as they head for retirement. Some key pointers to help are as follows:

- Always be aware of where the conversion of lock-up to cash issues are.
- Ensure that the value of WIP is convertible to bills.
- Resolve queries on bills promptly... if there is a minor query on a fee note the client probably won't pay the full amount of the bill
- Where possible agree that bills can be raised 'on account' as the work is undertaken. Professionals are usually more concerned about raising interim fees than clients are at receiving them!
- Don't work with clients who are habitually slow payers
- Be confident in stopping work if bills are not paid within agreed timescales.

Some types of work do not lend themselves to interim billing, but most do.

In smaller firms it easier to influence the lock up position than in much larger firms. However, the principles for calculating the lock-up are the same.

So take some time to consider the liquidity of your firm and the influence you can have to help smooth the way for a prompt and orderly repayment of amounts that are due to you!

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TOP SEVEN COMMON ACCOUNTING ISSUES FOR LAW FIRMS TO HELP IMPROVE THEIR FINANCIAL RECORDS

As part of the annual accounts and tax compliance service at Armstrong Watson we work with firms to prepare their financial statements, tax computations and returns based on information provided to us. However, we need to ensure that based on the information provided that the annual accounts produced are accurate and show the true financial performance of firms.

During the annual accounts process we will identify issues with the draft financial information provided to us and we will always highlight any adjustments necessary in reaching the final figures. We find that several of these accounting adjustments tend to be common amongst law firms and we have detailed seven of the most common occurring issues below.

How many of these issues do you recognise in your firm's own financial records?

1. Fixed assets

Many firms choose to capitalise all equipment purchased. This can range from a brand-new server costing thousands of pounds, down to replacement computer keyboards and mice for less than £50. Consideration should be given to setting a monetary limit for capitalisation, with anything below this value being treated as a renewal and charged to the profit and loss account.

A detailed fixed asset register should be maintained for additions and regularly updated to remove any assets either sold or disposed of. This can be as simple as setting up a spreadsheet, and by ensuring only equipment over a certain level is included should help keep track of the assets held. This then also becomes a useful tool when looking to renew building and contents insurance as key information is readily available.

Appropriate depreciation rates also need to be set for all categories of assets. For example, if a firm's policy is to renew laptops every four years, then computer equipment should be depreciated over four years to reflect the expected useful life of the asset.

2. Bad debt provision

Many firms do not calculate a provision for bad debts. All trade debtor balances should be reviewed as part of the year end procedures (and kept on top of monthly too) and relevant provision made for any balances not deemed recoverable. These balances could be specific debts for clients known to be 'bad debts' or any balances from clients due over payment days terms. This specific provision is then also a tax deductible cost for the firm.

Any unbilled disbursements should also be reviewed for recoverability and, again, provision made against any thought to be non-billable.

3. Prepayments

Law firms incur several large annual costs with professional indemnity insurance and practising certificates being the main examples. These expenses can cover multiple accounting periods, but financial information doesn't always reflect this with some firms treating the costs as an expense in the year they are incurred. This can have a significant negative impact on the recorded profitability of a firm. Any large expenses covering future accounting periods should be treated as prepayments so that relevant costs fall over the period the costs cover, including partially into future years.

4. Work in progress

Recoverable non-contingent work in progress (WIP) at the balance sheet date should be included within the firm's accounts. If a firm time records, this will not simply be the value of WIP recorded as at the year end. Any year end WIP reports need to be thoroughly reviewed to remove any non-recoverable or contingent WIP to leave a more accurate WIP figure. This can be done by applying a recovery rate based on historical analysis or reviewing actual billable WIP by client.

Furthermore if the firm's policy is not to time record, consideration needs to be given on how to value WIP accurately such as based on a percentage of completion for any fixed fee agreements. This policy should be applied consistently from year to year.

5. Loans and financing

Law firms frequently find it necessary to take out finance to cover costs such as professional indemnity insurance or to fund new computer software. It is important that any finance agreements are correctly set up within the accounts with relevant liabilities being included for the loans and interest accounted for correctly. There is sometimes a tendency with firms to include all finance repayments as a profit and loss expense, when in fact these are repayments of a liability and should be a balance sheet entry.

6. Ledgers not agreeing to nominal codes

As part of a firm's three way bank reconciliation, matter balances will be reviewed and checked against the client bank account on a regular basis. However, from our experience, checking the matter balances to the nominal ledger doesn't happen as often and differences can creep in. Differences between the ledgers and nominal codes tend to only occur when journal entries are posted in an attempt to correct an error. It is worth checking the matter balance to the nominal at the year end to ensure no differences have arisen.

This review should also be extended to cover trade debtors and trade creditors. The balances on their respective year end reports should be checked to ensure that they are agree to the values in the nominal and any differences swiftly investigated.

7. Accruals

Firms need to ensure that all late invoices are captured and recorded and any anticipated costs relating to the financial year in question are also included. As an example this will include the accountancy and SRA Accountant's report fees, and also various overhead costs such as heat and light relating to the year. Again, these will be tax deductible costs so are important not to be missed.

The above common accounting issues can have a substantial impact on a firm's profitability and results, and it may be that your firm can identify with some of these issues. If you are relying on your firm's financial records to make business decisions, then it is imperative they are as up to date and accurate as possible. The list above may seem overwhelming if they are adjustments that have never been factored in before, however, once set up they should quickly become embedded into a monthly or year-end routine.

If you would like further guidance on any of the above issues or would like some bespoke guidance around your own firm's accounting record keeping then please get in touch and see how we can help as part our annual accounts and tax compliance service.

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BEWARE – FRAUDSTERS WANT YOUR MONEY!

You may have seen a recent news article regarding Kent, a long-established business and hairbrush supplier to the royal family, who in minutes lost £1.6 million after falling prey to authorised push payment fraud ('APP') in July 2023.

APP relates to any fraud where a bank customer is scammed into making a transfer by instant payment and the funds have gone before the customer can stop it. In the Kent case, the fraudster convinced the financial controller that the company's funds were at risk and they were given access to the bank account. To date, none of the funds have been recovered or the fraudster identified.

You may think how can that happen? But, in the heat of being convinced that the business will lose all of its money, would you be thinking clearly? Maybe the staff were not aware of the threat of APP and didn't realise how it could happen to them.

It is startling to note that, in 2021 the UK lost £583 million to APP - and the threat is still growing. In many instances, it may take months to get any money back from the banks, if you ever manage to recover any at all. There are also very few instances where the fraudsters are caught.

For the business, management and employees, the impact of APP will almost certainly be considerable stress and disruption as you try to recover the funds from the banks involved; and we've seen examples where it could also involve:

- Employees not being paid as the funds have gone;
- Suppliers demanding payment but you have lost the funds you need to pay them;
- Significant legal costs for trying to persuade the banks and the regulators to reimburse the business; and
- In some instances, insolvency.

So how robust is your business to prevent it being caught by APP? Ask yourself the following questions:

- The fraudster may pretend to be from your bank and need your password and/or internet banking log on details. Do your staff know that a genuine bank employee would never ask for these details?
- The fraudster may contact you purporting to be from a supplier and advising that their bank details have changed. Do your staff know that they should check this with the supplier by phoning them on a number they know is associated with the supplier and, better still, the conversation being between a member of your staff and someone senior at the supplier who already know each other?
- The fraudster may be emailing you on an email address that is very similar to the supplier's. Do your staff know how to identify a fake email address or to check that the email address is the correct one you have on file?
- Do you keep a record of the contact details and a key contact name who your staff can speak to if they are being asked to make changes to the supplier details on your system?

If you are unable to say yes to any of the above then you need to review your procurement policies and procedures to ensure your staff have the tools to prevent you falling victim to APP or other scams.

As ever, the moral of the story is always prevention is better than cure. At Armstrong Watson we can help by reviewing your existing policies and procedures and assisting you to develop robust anti-fraud measures.

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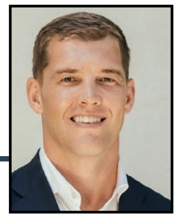
AN INTERVIEW WITH...



Andy Poole interviews Simon Luke, Country Manager for anti-money laundering (AML) technology platform First AML. Andy and Simon explore the common mistakes law firms make with anti-money laundering, developments in technology in the AML landscape, and quick wins that firms can make to their onboarding processes.

1. What types of law firms do you tend to work with?

First AML specialises in mid to large tier law firms across both the UK and globally. Our typical law firm client works with both businesses and individuals, often has several offices, and this is where misaligned anti-money laundering processes frequently arise. However, law firms do not need to be multi-office to feel the pain of manual and outdated AML processes – inefficient Know Your Customer (KYC) processes are a significant pain point across the board.

2. What common mistakes are you noticing with law firms with regards to KYC/AML?

The latest updates from the SRA have revealed that many firms do not have the necessary risk assessment documentation in place – whether that was at the firm-wide, client, or matter level. Many firms put together a gold-standard document with policies, controls, and procedures, but then leave it on the shelf without letting it inform other onboarding processes in their firm. In our experience, we also see an urge to use templates without reviewing them – and not considering whether the template actually fits the firm, the services they provide, and their typical client profile.

Another common mistake is that when things get busy, fee-earners can leave the KYC/CDD checks until after the fact, choosing to press on with billable work and not stop momentum in order to collect the necessary documentation.

This is particularly the case with complex or overseas entities when, to complete CDD checks, information or certified copies of documents may be required from parties not directly involved in the relevant matter, making it more difficult to so and more likely for fee earners to miss. It's an easy trap to fall into.

Non-compliance can have huge consequences, and firms need to prioritise having robust anti-money laundering processes in place. As most legal professionals know, AML non-compliance can lead to substantial fines and reputational damage. Globally, there was a 50 per cent surge in AML fines last year, with the financial hits on impacted entities totalling almost $5bn.

Internally, poor compliance processes can silently erode a firm's financial stability, too. A complex and protracted onboarding workflow can lead to the loss of clients and further business opportunities.

3. What sort of technology should law firms be looking to utilise?

There's no shortage of ways that technology can work to increase the amount of billables that fee-earners can generate. Speaking specifically in the AML space:

- automatically unravelling the structure and Ultimate Business Owners of multi-layered entities;
- AI that understands and recommends actions based on your risk appetite and compliance regulations; and
- automatic document collection

are all useful tools that can remove tasks and save time for fee-earners and/or centralised compliance teams where relevant. That time can then be put towards higher value activities.

There are also exciting developments in ongoing monitoring - so that if any changes in ownership structure occur, or if individuals go onto a sanctions list (all the more important now with recent world events) you're automatically updated.

Old methods of CDD fall short here - when client onboarding is the only time you're collecting this information, outdated data can leave firms vulnerable.

While implementing technology and establishing a comprehensive anti-money laundering programme does come at a cost, it's critical to see this as an investment rather than an expense. By strategically allocating resources and leveraging technology, firms can mitigate compliance costs while simultaneously protecting their reputation and financial stability.

4. If there was a quick win or action that you wished firms would take in regards to AML, what would it be?

Given the SRA's focus on AML training as the theme for their audits next year, if I was a law firm, I would take a look at what training you've got in place for your employees and evaluate if that training is fit for purpose.

I'd also recommend sitting down and mapping out your workflow when it comes to client onboarding. How many solutions are you using? Could they be consolidated? How much fee-earner time is being used on non-billable CDD activity? Could it be taken care of by support staff (or an automated platform)?

Asking questions like these will direct you to a more streamlined compliance process that can reduce double-handling, create a defensible audit-trail and free up the time of your most valuable and expensive resource - your people.

SIMON LUKE
COUNTRY MANAGER, FIRST AML

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