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17 September 2014

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Changes to Reporting Accountant Requirements – revised proposals

Purpose

- 1 The purpose of this paper is to present our revised proposals for changes to reporting accountant requirements and a revised response to the recent consultation, taking into account the Board's views from its discussion on 2 July 2014.

Recommendations

- 2 The SRA Board is asked to consider this paper and supporting information and:
 - (a) approve the proposal that we exempt from the requirement to obtain an accountant's report a small group of firms where the requirement can no longer be justified by the limited risks posed to client money;
 - (b) retain the existing requirement on all other firms to obtain an accountant's report if they hold client money but only require qualified¹ reports to be delivered to the SRA;
 - (c) approve the proposal that we update the format of the accountant's report to remove unnecessary information fields;
 - (d) approve the SRA's response to the consultation, attached at Annex 1;
 - (e) make the **SRA Amendments to Regulatory Arrangements (Accountants' Reports) Rules [2014]** subject to the approval of the Legal Services Board, as set out in Annex 3 to reflect the changes recommended in (a), (b) and (c) above; and
 - (f) endorse the longer term direction of travel set out in this paper.

If you have any questions about this paper please contact: Crispin Passmore, Executive Director, crispin.passmore@sra.org.uk; 0121 329 6687.

¹ As set out in the consultation document, qualification may occur for a range of reasons from minor breaches through to more significant problems. Minor breaches may include short delays in posting money to the client account, wrongly posting a payment that is subsequently corrected, or an amount being wrongly allocated between office and client account

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Changes to Reporting Accountant Requirements – revised proposals

Purpose

- 3 At its meeting on 2 July 2014, the Board was asked to consider an analysis of the responses to the recent consultation document proposing changes to the reporting accountant's requirements contained within the SRA Accounts Rules 2011 (the Accounts Rules)².
- 4 It was proposed that we would:
 - (a) proceed with removing the mandatory requirement that all firms must obtain and deliver an annual accountant's report to the SRA;
 - (b) retain a requirement for firms to deliver a final accountant's report within 6 months of ceasing to hold client money; and
 - (c) retain discretion to impose an obligation to deliver an accountant's report in some circumstances.
- 5 It was no longer proposed that Compliance Officers for Finance and Administration (COFAs) be required to sign a declaration that they are satisfied that the firm is managing the client account in accordance with the Accounts Rules.
- 6 While the Board agreed that the current arrangements were not sufficiently proportionate or targeted, the Board expressed concern with the proposal to remove the accountant's report requirement altogether, which it considered to be out of step with the approach taken by other regulators. The Executive was asked to return to the Board with a revised set of proposals that would retain an element of independent oversight in circumstances where there was a real risk to client money.
- 7 The Executive has carefully considered the Board's concerns and has developed what is considered to be a proportionate and targeted approach. The Board is asked to agree with the recommended approach for shorter-term changes and to endorse the longer-term direction of travel culminating in a comprehensive review of the Accounts Rules.

Proposal

- 8 We remain of the view that the current universal requirement for the delivery of accountants' reports is not sufficiently proportionate or targeted. The consultation document explained that around 9,000 firms hold client money and need to comply with requirements in the Accounts Rules to deliver an annual

² The "Proportionate regulation: changes to reporting accountant requirements" consultation document was published on 7 May 2014. The consultation closed on 18 June 2014 and a total of 147 responses were received.

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accountant's report. In 2013, of the 8,622 reports received 60% were qualified and therefore risk-assessed to determine if further action was necessary. The rest were placed into storage without further consideration as they did not identify any breaches of the Accounts Rules or risks to clients' funds.

- 9 Taking a more targeted and proportionate approach to the reporting accountant requirements remains a priority for the SRA. Not only does the current approach represent a significant administrative burden on the organisation and regulated community, we consider there are more effective ways to target those firms that pose the highest risk to client money. We are therefore proposing a phased approach, with increasingly targeted requirements culminating in a fundamental review of the Accounts Rules to be implemented through rule changes in April 2016. The first phase is expected to have minimal impact in practice, but will be helpful in giving a clear indication of the proposed approach.

Phase one – October 2014

- (a) Introduce an exemption from the requirement for all firms to obtain an accountant's report for the small group of firms where the requirement can no longer be justified by the limited risks posed to client money, in that they receive and hold 100% of their client money from Legal Aid Agency work.
 - (b) retain the existing requirement on all other firms to obtain an accountant's report within six months of the end of the accounting period to which the report relates but only require qualified reports to be delivered to the SRA within the same timeframe.
 - (c) Update the format of the accountant's report to remove unnecessary information fields.
- 10 The formal rule changes that give effect to these proposals are attached at Annex 3 as well as, for the Board's ease of reference, a track changed version of the Rules and the revised form of the accountant's report.

Phase two – April 2015

- Amend the Accounts Rules to reflect revised criteria for the circumstances in which accountant's reports need to be qualified
- Issue a fully revised format for the accountant's report
- Amend the overseas provisions of the Accounts Rules, in light of consultation responses
- Consider whether there are further categories of firms we can exclude from the requirement to obtain an accountant's report

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Phase three – April 2016

- (a) Conduct a full review of the Accounts Rules to be implemented through rule changes in April 2016³

Rationale and impact of changes

Changes to requirements to deliver an accountant's report

- 11 In response to the Board's concerns, for the first phase we are proposing to retain the requirement that the majority of firms which hold client money need to obtain an accountant's report within the existing time frame of six months after the end of their accounting period . However, following closer review of the firms affected, we consider that the requirement can no longer be justified for that small number of firms that only hold client money received from the Legal Aid Agency . We are therefore proposing to exempt these firms from October 2014 by amending the Accounts Rules to reflect the change proposed. We expect that this change will remove the requirement to obtain reports from approximately 115 firms⁴. We have discussed the issue with Legal Aid Agency and, while we are waiting a formal answer, they do not appear to envisage any concern with our proposal.

Requirement to deliver only qualified reports

- 12 As the Board is aware, at present our resources are focused on reviewing those accountant's reports that are qualified. The rest are simply received and placed into storage at a cost to the SRA on the basis that they do not identify any breaches of the Accounts Rules or risks to clients' funds. It is therefore proposed that the Accounts Rules be amended to require firms to deliver to the SRA only those reports which have been qualified. Over an entire year, this would reduce the number of reports we receive by as much 50-60%⁵ and be likely to result in some administrative savings for the organisation.
- 13 The Board should note that the impact in 2014 will be limited due to timing of the rule changes. We estimate that 46% of the year's reports will have been delivered before any rule changes come into effect. However we believe that this provides an important signal of our intention to make our regulation more proportionate and targeted and sets a clear direction for our future policy.

³ We announced our intention to consider the current SRA Accounts Rules "with the aim of reducing length and complexity and a consideration of alternatives to the holding of client money and consideration of the risks and incentives related to the holding of such money" in the SRA May 2014 Policy Statement on 'Approach to Regulation and its Reform' <http://www.sra.org.uk/sra/policy/regulation-reform.page>

⁴ Data obtained from the annual PC renewal exercise in 2013/2014

⁵ In 2013 we received a total of 8622 accountant reports of which 5216 (60%) were qualified. In the period January to July 2014, we received a total of 3189 reports, of which 1584 (50%) were qualified. We are expecting to receive a total of 3596 reports in September and October, 46% of the 7860 reports we expect in total for the year without a change to the rules

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Further, we can expect to see an immediate reduction in the number of reports received⁶.

Revised criteria for qualification

- 14 In the second phase, planned for April 2015, we are proposing to develop criteria that will redefine the circumstances in which accountant's reports need to be qualified so that we can rely more on the accountant's professional judgment in identifying significant risks to clients monies and interests. These criteria will allow us to take a significantly more targeted and risk based approach to which reports are delivered to us, allowing us to prioritise our resources more effectively in future.
- 15 The initial response of key stakeholders to these proposals has been positive. We consider that such an approach will retain a crucial element of independent oversight over firms that hold client money but will do so in a more proportionate and targeted way. Developing the criteria will, however, take time and require careful consultation with stakeholders including the accountants who, under the proposals, will be required to confirm to us that they have exercised their professional judgement in identifying key risks to client money. We are therefore proposing to implement the revised criteria (through changes to the Accounts Rules) in April 2015, subject to Board approval.

Simplification of the format for the accountant's report

- 16 Discussions flowing from the consultation have raised a number of issues with the current format of the report. It is clear that a thorough review is required to ensure that the checks and tests we require accountants to take prior to preparing the report and the reports themselves are fit for purpose and place minimum burdens (and therefore cost) on the firms concerned. It is therefore proposed that we proceed on the basis that we will seek to amend the Accounts Rules to simplify or amend wherever possible the test procedures and report's format by April 2015, alongside the revised qualification criteria referred to above.
- 17 However, we consider a number of simple amendments to the format can be made ahead of that, such as the removal of information fields that are already held by the SRA. The prescribed version of the form is set out at Appendix 5 of the Accounts Rules and the new format would therefore become available from 31 October 2014, subject to Board approval of the rule changes. We have taken the opportunity when streamlining the form to require accountants to deliver the completed checklist and signed report to the firm's current COFA, rather than, as currently set out, to all of the managers. We consider that this is logical, given the COFA's responsibility in the Authorisation Rule to monitor compliance by the firm with the Accounts Rules. We have, however, specifically referred to the COFA's requirement to provide a copy of the report to all the members in the proposed amended guidance note (iv) to Rule 44.1 of the Accounts Rules.

⁶ We are expecting a total of 836 reports to be submitted in November and December

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Commencement date

- 18 The consultation document set out our intention to implement the proposal in October 2014, to coincide with this year's PC renewal process, which ends on 31 October.
- 19 The revised proposals set out in this paper and in our response to consultation that constitute "Phase One" will be implemented through amendments to the Accounts Rules. We propose that those changes, subject to Board and LSB approval, will take effect from 31 October 2014 to coincide with the next edition of the SRA Handbook. This means that:
 - (a) any firms with an accounting period that ends before 31 October 2014 will need to obtain and deliver to us in the normal way an accountants' report within 6 months of the end of the period to which the report relates (or to apply for a waiver to do so, if considered necessary);
 - (b) any firms with an accounting period that ends on 31 October 2014 or after will be required to obtain an accountants' report within six months of the end of the period to which the report relates but will only be required to deliver any such qualified reports to us (or to apply for a waiver to do so, if considered necessary) ; and
 - (c) any firms that only hold client money received from the Legal Aid Agency and with an accounting period that ends on 31 October 2014 or after, will not be required to obtain an accountant's report.

Resource implications

- 20 The revised phase one proposals will not have the impact envisaged in the original consultation paper or in the post consultation position presented to the Board in July. This is mainly due to the decision to retain a requirement for most firms to obtain accountant's reports but only deliver qualified reports to us. However, it is estimated we will make administrative savings due to the reduction in the unqualified reports that we will need to process and store by approximately 50%.
- 21 Phases two and three are expected to result in additional administrative savings as we further reduce the number of reports received as well as the costs incurred by firms in obtaining the reports. It is not possible to quantify what the precise impact will be at this stage but the Board will be kept updated at the relevant points.

Consumer impact

- 22 The Accounts Rules are designed to provide an important protection to consumers by safeguarding their money. The proposals do not reduce or dilute in any way the obligations on firms, their managers or employees to comply fully with these obligations. It has been suggested that the requirement to obtain an

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independent accountant's report provides a deterrence to breaches of the Accounts Rules - although this is hard to evidence.

- 23 The Board will appreciate that these proposals do involve some degree of risk. By only requiring delivery of qualified accountant's reports, we will lose the controls and checks that are presently in place to ensure that firms do in fact obtain such reports .In addition we will be relying on firms to ensure that any qualified reports are in fact delivered to us. At present the requirement to obtain and deliver the reports rests with the firm and its managers – and not with the accountants. We may look to see if this can be amended in phase two or three of this project. The consequence of the change proposed is that if a firm fails to obtain a report at all or if one is obtained but is not sent to us (because it is qualified and the firm do not want to alert us to this fact) we will not now become aware of this. The risks involved are reduced by the fact that, provided accountants are instructed, they have an obligation to inform us immediately of any serious concerns. The risk involved if firms fail to obtain a report at all can be mitigated by a degree of checking of firms that reports have been obtained and robust enforcement action if firms fail to obtain reports when they are required to do so. There will be resource implications for Risk, Supervision and Enforcement that need to be taken into account, although the likely impact cannot not be quantified.

Equality and Diversity

- 24 See the impact statement attached at Annex 2.

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Supporting information

Links to the Strategic Plan and / or Business Plan

- 25 The proposal is linked to Strategic Objective two: Deliver risk-based outcomes-focused regulation so as to achieve positive outcomes for consumers in the public interest and do so in a way that is justifiable to all our stakeholders.
- 26 The proposed changes are part of a programme of reforming our regulatory regime to reduce unnecessary burdens on authorised bodies and individuals. This proposal is the first phase of a more general programme of work culminating in a proposed review of the SRA Accounts Rules to ensure that they are fit for our regulatory purposes.

How the issues support the principles of better regulation

- 27 The proposed immediate rule changes and phased implementation of this project support the principles of better regulation. In the shorter term, this specifically involves removing a small number of firms from the requirement where we think there is little risk to client funds involved, removing the blanket obligation which requires all firms to deliver to the SRA unqualified reports, and by streamlining the form of the existing report. Together with further reforms planned for phase two and three of this project, these changes should reduce the SRA's costs in processing and storing reports where little risk has been identified and the costs imposed on firms, replacing it with more proportionate and targeted arrangements.

What engagement approach has been used to inform the work (and what further communication and engagement is needed)

- 28 We have consulted informally with accountancy bodies on the proposals set out in the paper. If the Board endorses the direction of travel we will issue a further consultation on the proposals indicated in phase two of this project later in the autumn of 2014, and will continue our targeted programme of engagement with key stakeholders.

If you have any questions about this paper please contact: Annette Lovell, Director of Regulatory Policy, Annette.Lovell@sra.org.uk, (0121) 329 6222

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Annexes

Annex 1 – Summary of responses and draft response to the consultation

Annex 2 – Impact Statement

Annex 3 – Draft SRA Amendments to Regulatory Arrangements

(Accountants' Reports) Rules [2014] and track changed version of the Accounts Rules and form of Accountant's report

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Proportionate regulation: changes to reporting accountant requirements

Summary of responses

Introduction

- 1 On 7 May 2014 we issued a consultation document seeking views on proposals to change the requirement to deliver annual accountant's reports. The proposals were designed to ensure that regulation is proportionate and targeted, with the aim of reducing costs for legal services providers and consumers.
- 2 The consultation closed on 18 June 2014. This report summarises the key points emerging from the responses, and the SRA's position as a consequence.
- 3 A summary by number of the answers to the questions posed is at Appendix 1. A breakdown of the composition of respondents and a list of those respondents who consent to their details being publicised is at Appendix 2.

Overview and next steps

- 4 The consultation included two proposals for changes to the SRA Handbook:
 - the removal of the mandatory requirement that firms must deliver an annual accountant's report to the SRA; and
 - a new obligation for COFAs to sign an annual declaration that they are satisfied that the firm is managing its client account in accordance with the SRA Accounts Rules 2011 (the Accounts Rules).
- 5 We received a total of 147 responses. We have been encouraged by the number and quality of the responses and are grateful for both the formal written responses we have received and the opportunity to engage with stakeholders at meetings and events during the consultation period. Respondents included the Law Society and local groups, a wide range of legal services providers, accountancy firms and their representative bodies, and an insurance company. Several of the accountancy firms acknowledged that they had commercial interest in the outcome of the consultation. There were no responses from consumers or their representatives.

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- 6 Some respondents expressed clear reservations about the period of the consultation suggesting that it was too short to allow for a full exchange of views, because the consultation was issued at the same time as other consultation documents. While we acknowledge this concern, we are reassured that there was widespread awareness of and engagement with the proposals, evidenced by their coverage by the media, the number and range of responses we have received, and our discussions with stakeholders. We are confident that we have had the opportunity to consider the full range of views.
- 7 There was broad support for the SRA's desire to move towards more proportionate and targeted regulation. Nevertheless, a majority of respondents disagreed with removing the annual requirement for an accountant's report – although many of those that did so felt that the format needed to be changed to make it fit for purpose. Many respondents agreed that the requirement to deliver accountants' reports places a financial burden on firms, although not all agreed that its removal should be considered separately from a full review of the Accounts Rules. Some respondents described the way in which they used accountants' reports within their firms, emphasising the value of having an element of independent scrutiny, and there were many references to reports being a powerful deterrent to non-compliance.
- 8 Although some respondents agreed with the proposal to require COFAs to make an annual declaration, the vast majority did not. There were strong views expressed about the additional burden that this would place on COFAs. Respondents identified the possibility that COFAs would commission accountants' reports in order to sign a declaration, and that the expected savings would therefore not materialise.
- 9 We have carefully considered all of the points raised in the consultation and remain of the view that the current universal requirement to obtain and deliver an accountant's report is not sufficiently proportionate or targeted. The strength of views raised in consultation regarding the risks presented by the removal of an annual requirement for all firms has led us to review our original proposals in light of our longer term plans to review the Accounts Rules as a whole.
- 10 It is no longer proposed that COFAs will be required to sign a declaration that they are satisfied that the firm is managing client account in accordance with the Accounts Rules.

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- 11 We will be amending our original proposal to remove the mandatory requirement that all firms must deliver an annual accountant's report to the SRA. Instead we will:
 - (a) Introduce an amended version of the requirement for firms to obtain an accountant's report that exempts a small group of firms where the requirement can no longer be justified by the limited risks posed to client money; and
 - (b) Require all other firms to obtain an accountant's report but only qualified reports will need to be delivered to the SRA.
- 12 In response to the feedback received we have also made some straightforward amendments to the format of the accountant's report, removing unnecessary fields such as the requirement to provide a list of partner names (i.e. information already held by the SRA).
- 13 These proposals constitute "Phase One" of a longer-term strategy and will be implemented through amendments to the Accounts Rules to take effect from 31 October 2014, subject to approval by the Legal Services Board . This means that:
 - (a) any firms with an accounting period that ends before 31 October 2014 will need to prepare and deliver to us, in the normal way, an accountants' report within 6 months of the end of the period to which the report relates (or to apply for a waiver to do so, if considered necessary);
 - (b) any firms with an accounting period that ends on 31 October 2014 or after will be required to deliver only qualified reports within six months of the end of the period to which the report relates; and
 - (c) any firms that do only legal aid work and with an accounting period that ends on 31 October 2014 or after will not be required to obtain an accountant's report.
- 14 Phase two will involve further targeting of our requirements through the redefinition of the circumstances in which accountant's reports need to be qualified. The revised criteria and related amendments to the format of the report will be implemented through changes to the Accounts Rules in April

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2015, subject to further consultation. We will also consider whether there are further categories of firms we can exclude from the requirement to obtain an accountant's report and consider the requirements imposed by the overseas accounts provisions of the Accounts Rules in light of the risks and impacts involved

- 15 The third and final phase will involve a major review of the Accounts Rules as a whole to be implemented through rule changes in April 2016.

The responses

Question 1: Do you agree with the removal of the mandatory requirement that all firms holding client money must submit an annual accountant's report?

- 16 The majority of respondents were opposed to this proposal, although there was a substantial minority in support. As indicated above, many who wanted to retain the reports felt that the current format was not fit for purpose.
- 17 The Law Society recognised that the requirement to deliver a report places a financial burden on firms, but said that it provides an important external review. Other respondents acknowledged that there would be savings to firms if the requirement were removed. However, a number of respondents disagreed with the proposal on the grounds that it would represent no cost saving to firms if COFAs were required to make a declaration of compliance at the same time, suggesting that a higher cost would be incurred in satisfying what was regarded as a more onerous obligation.
- 18 One respondent suggested that accountant's reports are "...historic and of little assistance, and an unnecessary burden for firms in both cost and time." In one of two responses, an accountancy firm identified some of the wider benefits of reports, such as helping to identify staff training requirements, and their value to professional indemnity insurers and to future investors.
- 19 Another respondent suggested that: "Firms' managements quite often like the reassurance of knowing that someone else has looked at the systems and their operation. They like knowing that there is another pair of eyes that will be watching them."
- 20 The City of London Law Society distinguished between the obligations to commission a report and then deliver it to the SRA, suggesting that the two had

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been conflated in the consultation document and that the former could be maintained without the latter. With reference to the low number of reports referred for further regulatory action, it asked for evidence to demonstrate the extent to which reports act as a deterrent to non-compliance. Other respondents also suggested the reports were a deterrent, for example the Building Societies Association which said they were "...an essential anti-fraud measure, both as a deterrent and to detect any wrongful activity."

SRA response

- 21 We have carefully considered these views and understand that they are relevant and important points, but are not persuaded that they amount to a case for maintaining the status quo. We acknowledge that there is limited evidence to support the proposal to remove the obligation. Equally, however, we consider that there is limited evidence to support the suggestion that they act as a deterrent to non-compliance. This is probably inevitable given the difficulty of identifying the drivers for compliance in the face of a range of different obligations.
- 22 The consultation document explained that around 9,000 firms hold client money and need to comply with the requirement in the Rules to deliver an annual accountant's report. It said that "From the total number of reports received, about 200 are referred for further examination after internal processing and risk assessment, and usually only about 10 result in a referral to supervision for further investigation". This statement requires clarification.
- 23 Almost half of the reports we receive are qualified and therefore risk-assessed in order to decide if further action is necessary. In fact, during the period from June 2012 to December 2013, 179 reports were referred for consideration of further action, mainly for the following reasons:
 - (a) a failure to undertake 5-weekly reconciliations or improper or incomplete accounting records;
 - (b) a failure to account to clients;
 - (c) office account issues - such as client money being improperly held in office account; and

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- (d) debit balances on client account.
- 24 Of these 179 reports, 38 do not yet have a decision or outcome as they are still being investigated. Of the remaining 141 reports assessed, over 90% resulted in no further action or were resolved informally, for example through supervisory engagement or the issuing of a letter of advice. Eight resulted in regulatory or disciplinary action such as a fine or a referral to the Solicitors Disciplinary Tribunal (SDT). It is unclear from the data whether there were other factors involved in those cases that would have triggered regulatory action.
- 25 An analysis of our data shows that an additional five reports in the period referred to above contributed to varying extents to our decision to intervene into the firm concerned. In two of the matters, receipt of the qualified accountant's report led directly to the commission of an onsite investigation that formed the basis of the decision to intervene. In the other three cases, receipt of the qualified accountant's report was one of several pieces of intelligence or data that we held that resulted in an investigation and the intervention resolution. Each of these cases presented a high risk to consumers and in the absence of the accountant's reports it is possible, certainly in the two cases referred to, that we might not have been able to detect and act upon that risk. In the other cases, it is likely that we could have imposed a condition to require the delivery to us of an accountant's report because of the existing risk factors. In one recent intervention, it is interesting to note that we were alerted to very serious concerns about the handling of client money and unreplaced shortages in client account by the new bookkeeper who reported his concerns to us. He pointed out that the existing accountants had in fact submitted unqualified reports to us over the last several years and we found significant breaches of the Accounts Rules on the subsequent inspection. Overall, we accept that there will be a risk of loss of intelligence by the removal of the requirement as highlighted in these cases.
- 26 The culture of professionalism and compliance among solicitors and their firms provides a very solid starting point for compliance, and the severe consequences from being found not to be in compliance supports this. The fact that the SDT highlighted in their response to the consultation at least 25 cases in the 2013 where breaches of the Accounts Rules led to prosecution before the SDT (with many of those cases which involved deliberate misuse of client monies leading to a solicitor being removed from the roll) provides us with

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confidence that the sanctions available to us are such that some will be deterred from wrong doing.

- 27 We wholly agree with the SDT's comments in its response that the safeguarding of client's monies is sacrosanct. Nothing that we have proposed in the original consultation or in this response in any way affects or dilutes this requirement. Of the cases the SDT referred to, our data shows that only a small minority of the underlying investigations were triggered by receipt of the qualified accountant's reports. The significant majority of the investigations that led to the outcome at the SDT were triggered by other factors such as self reports or other pieces of intelligence. Five matters involved, amongst other allegations, a failure to deliver an accountant's report as required by the Accounts Rules. However, these matters generally resulted in a small fine being imposed by the SDT.
- 28 Of these five matters, we note that two cases related to a failure to deliver a 'cease to hold' report on closure, a requirement we now propose to retain. In one case, however, the investigation was triggered by an immediate report of concerns by the firm's accountant that we accept we may not have received without the requirement.
- 29 We have therefore decided to implement an amended version of the original proposal whereby firms, with the exception of those that do only legal aid work, will continue to be required to obtain an annual accountant's report, although only qualified reports (under the existing criteria) will need to be delivered to us. We consider this to be a more proportionate approach to the existing universal requirement, which will also allow us to retain an important information source for a transitional period while we seek to redefine the criteria for qualification.

Question 2: Do you agree with the proposed amendment to the role of the Compliance Officer for Finance and Administration?

- 30 A small number of respondents agreed with this proposal. The Building Societies Association said "...it would be useful for the COFA to sign a declaration that they are satisfied that the firm is managing its client account in accordance with SRA Accounts rules. This seems like a sensible declaration."
- 31 Significantly more respondents disagreed. A number cited the relatively recent introduction of the role of COFAs and suggested that the proposal would amount to an onerous obligation on individuals which would lead to the

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perception that COFAs were solely responsible for a firm's compliance with the Accounts Rules. Asian Lawyers GB suggested that "Many lawyers would be put under pressure, by their employers, to make a declaration regardless of their views or understanding as to what they are declaring." One respondent thought that the obligation was unlikely to create a problem for small firms, but would be more difficult for COFAs in larger firms. Others suggested that the vast majority of COFAs would be unwilling to sign a declaration without obtaining independent verification. The Leicestershire Law Society suggested that the proposal might increase the risk of being unable to attract suitable candidates to act as COFAs. This view was echoed by an accountancy firm which said "We believe that this will place an unfair burden on COFAs many of whom we know first hand were appointed because there was 'no-one else' in the practice suitable or willing to carry on the role... "

- 32 Many respondents suggested that, if implemented, the proposal should be more clearly defined. For example the Law Society pointed out that given "...the high level of qualified accountants' reports, it seems likely that a significant number of COFAs will be unable to confirm that they have fully complied with the SARs over the year. It is unclear how the SRA will deal with reports of minor breaches and the cost implications of doing so."

SRA response

- 33 We believe that many of these points are well made and agree that the proposal might be disproportionate. We are particularly persuaded by the suggestion that it might lead to a perception that ensuring compliance with the Accounts Rules is the responsibility of the COFA alone and, as such, would be counter-productive. We are also conscious of the need not to elevate certain rules to a higher status through the use of declarations, and to avoid the use of declarations as a bureaucratic comfort blanket for removing poorly targeted regulation. We have therefore decided not to pursue this proposal.

Question 3: Do you agree with the proposed changes to the SRA Accounts Rules?

- 34 Very few respondents commented in any great detail. There was some agreement that the proposed drafting would give effect to the proposed changes, but most respondents referred to their response to earlier questions, supporting or disagreeing with the proposals.

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Question 4: Do you have (or are you aware of) any evidence, analysis, or views that will assist us in completing an impact assessment on these proposals?

- 35 Most respondents did not provide a detailed response to this question. One commented that "...there is little evidence to dispute the assertion that where an industry is self-regulated....it leaves itself more open to abuse."
- 36 The Law Society expressed disappointment that "...this consultation has been published without any attempt at an impact assessment." It said it was particularly concerned about the impact of the proposals on those firms who are still required to deliver an accountant's report because it might be "viewed as a sanction by both clients and other stakeholders and may affect the firm's ability to join panels, obtain indemnity insurance and gain accreditation."
- 37 Several respondents answered this question by expressing their support for a wider review of the Accounts Rules and made suggestions of issues which could be considered as part of this review. We are grateful for these contributions and will ensure that they are addressed when the review commences.
- 38 Several respondents suggested that the experience of other regulators should be considered as a useful source of information, especially those which had both imposed and removed obligations for external oversight.

SRA response

- 39 An impact statement has been produced (insert link) and we consider that the revised proposals address the majority of concerns raised in response to this question.

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Type of respondent	Responses
Law firms / solicitors	72
Individuals	4
Accountancy bodies	35
Local law societies	19
Representative groups, trade and membership associations	6
Insurance	1
Risk management	1
Other	9
TOTAL	147

Respondents to the Consultation

This list includes only those who have agreed to their names appearing in a list of respondents

Law firms

A. L. Hughes & Co.
Access Law LLP
Alexander & Co. Solicitors LLP
ASB LAW LLP
Ashton KCJ
Bell Lax Ltd
Brethertons LLP
DAC Beachcroft LLP
Bennett Griffin LLP
Clifton Ingram LLP
Crowe Clark Whitehill LLP
DJM Law Limited
Davey Law Ltd

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David W Harris & Co
Duchennes Solicitors
Ellis Davies & Co.
Frith and Co
Hyland Fitzwater Solicitors
Hughes Paddison
Irwin Mitchell LLP
Jacky Lewis Family Law
Janes
Keens Shay Keens MK LLP
Kingsley Law Ltd
LR Law Limited Lupton Fawcett LLP
MDL Solicitors
Mayfield Bell
Minim Law Ltd
NABARRO LLP
Parrott & Coales LLP
Stanley Jacobs Solicitor
Tilly Bailey & Irvine LLP
Warners Law LLP
Winckworth Sherwood

Accountancy firms

D. A. Locke & Co, Chartered accountants
Ballards Newman (Finchley) Limited
Quantum Accountancy Services Ltd
Armstrong Watson
Palmer McCarthy
Dendy Neville
Mercia Group Limited
Chartered Accountancy Practice
McBrides Accountants LLP
Franklin Underwood
Grant Thornton UK LLP
Hazlewoods LLP
Wilkins Kennedy LLP
Mazars
Harwood Hutton Limited
PWC
Baker Tilly
Goringe Accountants Ltd
Ryecroft Glenton
Deloitte LLP
Moore Stephens LLP

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Representative Groups, trade and membership bodies, professional bodies

Asian Lawyers GB
Building Societies Association
Council of Mortgage Lenders
ICAEW
MHA Accountancy Network
Sole Practitioner Group
The Association of Accounting Technicians
The Law Society
UK 200 Group

Local Law Societies

Birmingham Law Society
Cambridgeshire & District Law Society
Chester & North Wales Law Society
City of London Law Society
CWHLS
Devon & Somerset Law Society
Hertfordshire Law Society
Leeds Law Society
Leicestershire Law Society
Manchester Law Society
Middlesex Law Society
Newcastle upon Tyne Law Society
Northamptonshire Law Society
Nottinghamshire Law Society
Plymouth Law Society
Southend Law Society
Sunderland Law Society
Surrey Law Society
Tunbridge Wells, Tonbridge & District Law Society

Insurance firms

Zurich Insurance plc

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Changes to reporting accountant requirements: impact statement

- 1 This impact statement comprises an assessment of the proposed changes to reporting accountant requirements against our regulatory objectives, and also in light of our public sector equality duties and the better regulation principles.
- 2 The proposed changes to the reporting accountant requirements are designed to ensure that regulation is proportionate and targeted. We consider that the proposed changes will benefit firms through the effective targeting of requirements to obtain and deliver to us an annual accountant's report.

Protecting and promoting the public interest:

- 3 Consumer confidence in the legal services market is underpinned by an expectation that client money will be safeguarded. This protection is primarily delivered through an obligation to comply with the SRA Accounts Rules 2011 (the Rules), which set out detailed requirements for the handling of client money. The current proposals do not change the substantive detail of those Rules. In fact, these proposals signal the start of a longer-term programme of work to review them in their entirety to ensure they are fit for purpose.
- 4 The rationale for our changing approach to regulation is the need to focus on provisions which are both targeted and proportionate, recognising that regulation which goes further can create unjustifiable costs for legal firms which are then passed onto consumers and may impact on wider access to justice.

Supporting the constitutional principle of the rule of law:

- 5 These proposals will have a neutral impact on the constitutional principle of the rule of law.

Improving access to justice:

- 6 As stated above, these measures are designed as part of an overall package of reforms to reduce unnecessary burdens for legal services providers and their clients. Research⁷ has shown that both individual consumers and small businesses currently struggle to access affordable legal services. We accept that these measures are only one part of the process and that we will need to go further in seeking to affect the

⁷ See 2013 'Small business legal needs survey' <https://research.legalservicesboard.org.uk/reports/consumers-unmet-legal-needs>

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market to increase competitiveness. However, decreasing the regulatory burden whilst increasing access to justice for consumers is not a question of taking only one step. Instead, it will take a series of incremental reforms across a range of areas and this policy change needs to be seen in that context

Protecting and promoting the interests of consumers:

- 7 It is important to acknowledge that the protection of consumers' interests goes beyond an objective of simply safeguarding their money. Their interests are protected more broadly by being able to access affordable legal services which deliver appropriate outcomes with competence and integrity. Such access is secured not only by making services available and affordable, but also through establishing consumer confidence in the wider legal system and legal services providers.
- 8 It has been suggested that the removal of a blanket requirement to deliver accountants' reports will result in a reduction in consumer protection and consumer confidence because it will remove a deterrent to non-compliance with the Rules. We consider the amendment to our proposals to require the delivery of qualified reports will effectively mitigate this risk.

Promoting competition in the provision of services such as are provided by authorised persons:

- 9 Competition thrives in markets which are free from unnecessary intervention. We consider the revised proposals present a more proportionate approach to the reporting accountant requirement and provide a clear signal of our longer-term approach.

Encouraging an independent, strong, diverse and effective legal profession:

- 10 BME solicitors continue to be disproportionately over-represented in sole practices and the smallest firms⁸. It is therefore important to consider the impact of these proposals on smaller firms.
- 11 It is probable that many firms would have continued to commission an accountant's report were the original proposals removing this requirement have gone ahead. Under

⁸ 50.5% of BME solicitors work in sole practices or firms with 2 to 4 partners compared to 28.7% of White European solicitors and 30% of BME solicitors work in firms with 26 or more partners compared with 42.6% of White European solicitors <https://research.legalservicesboard.org.uk/wp-content/media/Review-of-published-evidence-on-the-equality-of-pay-in-legal-services-Final.pdf>

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the revised proposals, these firms will only have to deliver qualified reports to us and a section of firms will be exempt from the requirement altogether. We consider this to be a targeted and proportionate response to the risks posed. Further, in our response to consultation, we have signalled a clear long-term strategy to more clearly define the criteria for qualification, which will give firms greater certainty as to the areas we will focus upon.

- 12 We therefore believe that proceeding with this proposal will help implement recommendation 20 of the Independent Comparative Case Review (ICC) report commissioned by the SRA and published in March 2014:
- (a) Publish proposals to reduce the regulatory burden for small firms and to improve our engagement with, and regulation of, them.
 - (b) Pursue a programme of regulatory reform to ensure our regulation is more targeted and proportionate.

Increasing public understanding of the citizen's legal rights and duties;

- 13 These proposals will have a neutral impact on public understanding of the citizen's legal rights and duties.

Promoting and maintaining adherence to the professional principles:

- 14 The proposals do not reduce or dilute the obligation to comply with the SRA Accounts Rules or with the broader requirements in the Code of Conduct and Handbook to safeguard clients' monies and protect their interests.

The better regulation principles

These measures support the better regulation principles of being targeted and proportionate. They remove a blanket requirement to deliver accountants' reports, which applies to all firms regardless of the risk they pose, and put in place a more targeted requirement for reports to be obtained and delivered to us only where necessary.

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Draft SRA Amendments to Regulatory Arrangements (Accountants' Reports) Rules [2014]

Preamble

Rules dated [date of approval by LSB] made by the Solicitors Regulation Authority Board under sections 28, 31, 32, 79 and 80 of the Solicitors Act 1974, section 9 of the Administration of Justice Act 1985 and section 83 of, and Schedule 11 to, the Legal Services Act 2007, with the approval of the Legal Services Board under paragraph 19 of Schedule 4 to the Legal Services Act 2007.

Rule 1

The SRA Accounts Rules 2011 shall be amended as follows:

- (a) replace rule 32 (Delivery of accountants' reports) with:

"32.1 Subject to rule 32.1A, if *you* have, at any time during an *accounting period*, held or received *client money*, or operated a *client's* own account as signatory, *you* must:-

(a) obtain an accountant's report for that *accounting period* within six months of the end of the *accounting period*; and

(b) if the report has been qualified, deliver it to the SRA within six months of the end of the *accounting period*.

This duty extends to the *directors* of a *company*, or the members of an *LLP*, which is subject to this rule.

32.1A Subject to rule 32.2, *you* are not required to obtain or deliver an accountant's report if all of the *client money* held or received during an *accounting period* is money held or received from the Legal Aid Agency or in the circumstances set out in rule 19.3

32.2 The *SRA* may require the delivery of an accountant's report in circumstances other than those set out in rules 32.1 and in the circumstances set out in rule 32.1A if the *SRA* has reason to believe that it is in the public interest to do so.";

- (b) the guidance notes to rule 32 shall be amended as follows:

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- (i) insert a new guidance note (i) to rule 32 as follows and renumber guidance notes (i) to (iii) accordingly:
 - “(i) A qualified accountant's report is a report prepared in accordance with rule 32.1(a) which the reporting accountant has found necessary to qualify. The form of the report is dealt with in rule 44. The circumstances in which the accountant will be required to qualify his or her report are set out in the form at Appendix 5 to these rules.”;
 - (ii) delete guidance note (iv);
 - (iii) in guidance note (vi) replace “deliver an accountant’s report” with “obtain the accountant’s report and to deliver any such report to the SRA if it is qualified”; and
 - (iv) in guidance note (xi) to rule 32, replace “deliver” with “obtain” and replace “Information Directorate” with “SRA”;
- (c) in guidance note (i) to rule 33.5, delete “In the case of persons joining or leaving a continuing partnership, any accountant's report for the firm as a whole will show the names and dates of the principals joining or leaving.”;
- (d) in guidance note (i) to rule 34.5, replace “disclose” with “confirm that” and replace “in the report” with “do not affect his or her independence in preparing the report”;
- (e) in rule 44.1, replace “section 4” with “section 2”;
- (f) replace guidance notes (i) to (vii) to rule 44 as follows:
- “Guidance notes
 - (i) The current form of accountant's report appears at Appendix 5. The report confirms if the accountant has found it necessary to qualify the report. If so, the report must be delivered to the SRA - see rule 32.1(b) and guidance note (i) to that rule.
 - (ii) Separate reports can be obtained for each principal in a partnership but most firms choose to obtain one report in the name of all the principals. In either case, the report must be delivered to the SRA if it is qualified - see rule 32.1(b) and guidance note (i).

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For assistant solicitors, consultants and other employees, see rule 32, guidance notes (vii) and (viii).

- (iii) An incorporated practice will obtain only one report, on behalf of the company and its directors, or on behalf of the LLP and its members - see rule 32.1. The report must be delivered to the SRA if it is qualified - see rule 32.1(b) and guidance note (i) to that rule.
 - (iv) Although it may be agreed that the accountant send any qualified reports direct to the SRA, the responsibility for delivery is that of the firm. The form of report requires the accountant to confirm that a copy of the report (whether qualified or unqualified) has been sent to the COFA on behalf of the firm to which it relates. The COFA should ensure that the report is seen by each of the managers of the firm.
 - (v) A reporting accountant is not required to report on trivial breaches due to clerical errors or mistakes in book-keeping, provided that they have been rectified on discovery and the accountant is satisfied that no client suffered any loss as a result.
 - (vi) In many practices, clerical and book-keeping errors will arise. In the majority of cases these may be classified by the reporting accountant as trivial breaches. However, a "trivial breach" cannot be precisely defined. The amount involved, the nature of the breach, whether the breach is deliberate or accidental, how often the same breach has occurred, and the time outstanding before correction (especially the replacement of any shortage) are all factors which should be considered by the accountant before deciding whether a breach is trivial.
 - (vii) For direct reporting by the accountant to the SRA in cases of concern, see rule 35 and guidance note (i) to that rule.
- (g) in guidance note (i) to rule 46, replace "Information Directorate" with "SRA" and replace "deliver" with "obtain"; and
- (h) replace appendix 5 (Accountant's report form) with the Accountant's report form annexed to these rules.

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Rule 2

The SRA Practising Regulations 2011 shall be amended as follows:

- (a) in regulation 3(c), after “to” insert “obtain or”; and
- (b) in guidance note (iii)(f) to regulation 4.7, replace “submission” with “obtaining or delivery” and after “report” insert “(in accordance with rule 32 of the SRA Accounts Rules 2011).”

Rule 3

The SRA Authorisation Rules for Legal Services Bodies and Licensable Bodies 2011 shall be amended as follows:

In guidance note (iii)(f) to Rule 8, replace “submission” with “obtaining or delivery” and after “report” insert “(in accordance with rule 32 of the SRA Accounts Rules 2011)”.

Rule 4

These rules shall come into force on 31 October 2014 or the date of approval by the Legal Services Board, whichever is the later.

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SRA Accounts Rules 2011

Part 6 : Accountants' reports

Rule 32: Delivery of accountants' reports

32.1 ~~Subject to rule 32.1A, if~~ you have, at any time during an *accounting period*, held or received *client money*, or operated a *client's* own account as signatory, you must:-

~~(a) obtain an accountant's report deliver to the SRA an accountant's report~~ for that *accounting period* within six months of the end of the *accounting period*; and

~~(b) if the report has been qualified, deliver it to the SRA within six months of the end of the~~ *accounting period*.

This duty extends to the *directors* of a *company*, or the members of an *LLP*, which is subject to this rule.

32.1A Subject to rule 32.2, you are not required to obtain or deliver an accountant's report if all of the *client money* held or received during an *accounting period* is money held or received from the Legal Aid Agency or in the circumstances set out in rule 19.3

~~In addition to~~ The SRA may require the delivery of an accountant's report in ~~circumstances other than those set out in rules 32.1 and in the circumstances set out in rule 32.1A above~~ if the *SRA* has reason to believe that it is in the public interest to do so.

Guidance notes

~~(i)~~ (i) A qualified accountant's report is a report prepared in accordance with Rule 32.1 (a) which the reporting accountant has found necessary to qualify. The form of the report is dealt with in rule 44. The circumstances in which the accountant will be required to qualify his or her report are set out in the form at Appendix 5 to these rules.

~~(i)(ii)~~ (ii) Examples of situations under rule 32.2 include:

- (a) when no report has been delivered but the SRA has reason to believe that a report should have been delivered;

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- (b) when a report has been delivered but the SRA has reason to believe that it may be inaccurate;
 - (c) when your conduct gives the SRA reason to believe that it would be appropriate to require earlier delivery of a report (for instance three months after the end of the accounting period);
 - (d) when your conduct gives the SRA reason to believe that it would be appropriate to require [delivery in all circumstances or](#) more frequent delivery of reports (for instance every six months);
 - (e) when the SRA has reason to believe that the regulatory risk justifies the imposition on a category of firm of a requirement to deliver reports earlier or at more frequent intervals;
 - (f) when a condition on a solicitor's practising certificate requires earlier delivery of reports or the delivery of reports at more frequent intervals.
- (ii)(iii) For accountant's reports of limited scope see rule 8 (liquidators, trustees in bankruptcy, Court of Protection deputies and trustees of occupational pension schemes), rule 9 (joint accounts) and rule 10 (operation of a client's own account). For exemption from the obligation to deliver a report, see rule 5 (persons exempt from the rules).
- (iii)(iv) The requirement in rule 32 for a registered foreign lawyer to deliver an accountant's report applies only to a registered foreign lawyer practising in one of the ways set out in paragraph (vi)(C) of the definition of "you" in the Glossary.
- ~~(iv) — The form of report is dealt with in rule 44~~
- (v) When client money is held or received by an unincorporated practice, the principals in the practice will have held or received client money. A salaried partner whose name appears in the list of partners on a firm's letterhead, even if the name appears under a separate heading of "salaried partners" or "associate partners", is a principal.
 - (vi) In the case of an incorporated practice, it is the company or LLP (i.e. the recognised body or licensed body) which will have held or

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received client money. The recognised body/licensed body and its directors (in the case of a company) or members (in the case of an LLP) will have the duty to obtain the accountant's report and to deliver any such report to the SRA if it is qualified ~~accountant's report~~, although the directors or members will not usually have held client money.

- (vii) Assistant solicitors, consultants and other employees do not normally hold client money. An assistant solicitor or consultant might be a signatory for a firm's client account, but this does not constitute holding or receiving client money. If a client or third party hands cash to an assistant solicitor, consultant or other employee, it is the sole principal or the partners (rather than the assistant solicitor, consultant or other employee) who are regarded as having received and held the money. In the case of an incorporated practice, whether a company or an LLP, it would be the recognised body or licensed body itself which would be regarded as having held or received the money.
- (viii) If, exceptionally, an assistant solicitor, consultant or other employee has a client account (as a trustee), or operates a client's own account as signatory, the assistant solicitor, consultant or other employee will have to deliver an accountant's report. The assistant solicitor, consultant or other employee can be included in the report of the practice, but will need to ensure that his or her name is added, and an explanation given.
- (ix) If a cheque or draft is made out to you, and in the course of practice you endorse it over to a client or employer, you have received (and paid) client money. You will have to deliver an accountant's report, even if no other client money has been held or received.
- (x) Rule 32 does not apply to a solicitor or registered European lawyer, employed as an in-house lawyer by a non-solicitor employer, who operates the account of the employer or a related body of the employer.
- (xi) When only a small number of transactions is undertaken or a small volume of client money is handled in an accounting period, a waiver of the obligation to obtain deliver a report may sometimes be granted. Applications should be made to the SRA. Information Directorate.

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- (xii) If a firm owns all the shares in a recognised body or licensed body which is an executor, trustee or nominee company, the firm and the recognised body/licensed body may deliver a single accountant's report (see rule 28.1(b)).

Rule 33: Accounting periods

The norm

33.1 An "accounting period" means the period for which **your** accounts are ordinarily made up, except that it must:

- (a) begin at the end of the previous **accounting period**; and
- (b) cover twelve months.

Rules 33.2 to 33.5 below set out exceptions.

First and resumed reports

33.2 If **you** are under a duty to deliver **your** first report, the **accounting period** must begin on the date when **you** first held or received **client money** (or operated a **client's** own account as signatory), and may cover less than twelve months.

33.3 If **you** are under a duty to deliver **your** first report after a break, the **accounting period** must begin on the date when **you** for the first time after the break held or received **client money** (or operated a **client's** own account as signatory), and may cover less than twelve months.

Change of accounting period

33.4 If **you** change the period for which **your** accounts are made up (for example, on a merger, or simply for convenience), the **accounting period** immediately preceding the change may be shorter than twelve months, or longer than twelve months up to a maximum of 18 months, provided that the **accounting period** shall not be changed to a period longer than twelve months unless the **SRA** receives written notice of the change before expiry of the deadline for delivery of the accountant's report which would have been expected on the basis of **your** old **accounting period**.

Final reports

33.5 If **you** for any reason stop holding or receiving **client money** (and operating any **client's** own account as signatory), **you** must deliver a final report. The **accounting period** must end on the date upon which **you** stopped holding or receiving **client**

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money (and operating any *client's* own account as signatory), and may cover less than twelve months.

Guidance notes

- (i) ~~In the case of persons joining or leaving a continuing partnership, any accountant's report for the firm as a whole will show the names and dates of the principals joining or leaving.~~ For a person who did not previously hold or receive client money, etc., and has become a principal in the firm, the report for the firm will represent, from the date of joining, that person's first report for the purpose of rule 33.2. For a person who was a principal in the firm and, on leaving, stops holding or receiving client money, etc., the report for the firm will represent, up to the date of leaving, that person's final report for the purpose of rule 33.5 above.
- (ii) When a partnership splits up, it is usually appropriate for the books to be made up as at the date of dissolution, and for an accountant's report to be delivered within six months of that date. If, however, the old partnership continues to hold or receive client money, etc., in connection with outstanding matters, accountant's reports will continue to be required for those matters; the books should then be made up on completion of the last of those matters and a report delivered within six months of that date. The same would be true for a sole practitioner winding up matters on retirement.
- (iii) When a practice is being wound up, you may be left with money which is unattributable, or belongs to a client who cannot be traced. It may be appropriate to apply to the SRA for authority to withdraw this money from the client account - see rule 20.1(k) and guidance note (vi)(a) to rule 20.

Rule 34: Qualifications for making a report

34.1 A report must be prepared and signed by an accountant

- (a) **who is a member of:**
 - (i) the Institute of Chartered Accountants in England and Wales;
 - (ii) the Institute of Chartered Accountants of Scotland;
 - (iii) the Association of Chartered Certified Accountants;

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- (iv) the Institute of Chartered Accountants in Ireland; or
 - (v) the Association of Authorised Public Accountants; and
- (b) **who is also:**
- (i) an individual who is a registered auditor within the terms of section 1239 of the Companies Act 2006; or
 - (ii) an employee of such an individual; or
 - (iii) a *partner* in or employee of a *partnership* which is a registered auditor within the terms of section 1239 of the Companies Act 2006; or
 - (iv) a director or employee of a company which is a registered auditor within the terms of section 1239 of the Companies Act 2006; or
 - (v) a member or employee of an *LLP* which is a registered auditor within the terms of section 1239 of the Companies Act 2006.
- 34.2 An accountant is not qualified to make a report if:
- (c) at any time between the beginning of the *accounting period* to which the report relates, and the completion of the report:
 - (i) he or she was a *partner* or employee, or an officer or employee (in the case of a company), or a member or employee (in the case of an *LLP*) in the *firm* to which the report relates; or
 - (ii) he or she was employed by the same *non-solicitor employer* as the *solicitor* or *REL* for whom the report is being made; or
 - (iii) he or she was a *partner* or employee, or an officer or employee (in the case of a company), or a member or employee (in the case of an *LLP*) in an accountancy practice which had an ownership interest in, or was part of the group structure of, the *licensed body* to which the report relates; or
 - (d) he or she has been disqualified under rule 34.3 below and notice of disqualification has been given under rule 34.4 (and has not subsequently been withdrawn).
- 34.3 The *SRA* may disqualify an accountant from making any accountant's report if:

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- (e) the accountant has been found guilty by his or her professional body of professional misconduct or discreditable conduct; or
- (f) the **SRA** is satisfied that **you** have not complied with the rules in respect of matters which the accountant has negligently failed to specify in a report.

In coming to a decision, the **SRA** will take into account any representations made by the accountant or his or her professional body.

- 34.4 Written notice of disqualification must be left at or sent by recorded delivery to the address of the accountant shown on an accountant's report or in the records of the accountant's professional body. If sent through the post, receipt will be deemed 48 hours (excluding Saturdays, Sundays and Bank Holidays) after posting.
- 34.5 An accountant's disqualification may be notified to any **firm** likely to be affected and may be printed in the **Society's** Gazette or other publication.

Guidance note

- (i) It is not a breach of the rules for you to retain an outside accountant to write up the books of account and to instruct the same accountant to prepare the accountant's report. However, the accountant will have to confirm that disclose these circumstances do not affect his or her independence in preparing the report in the report- see the form of report in Appendix 5.

Rule 35: Reporting accountant's rights and duties - letter of engagement

35.1 **You** must ensure that the reporting accountant's rights and duties are stated in a letter of engagement incorporating the following terms:

"In accordance with rule 35 of the SRA Accounts Rules 2011, you are instructed as follows:

- (a) I/**this firm**/**this company**/**this limited liability partnership** recognises that, if during the course of preparing an accountant's report:
 - (i) you discover evidence of fraud or theft in relation to money
 - (A) held by a solicitor (or registered European lawyer, or registered foreign lawyer, or recognised body, or licensed body, or employee of a solicitor or registered European lawyer, or manager or employee of a recognised body or

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licensed body) for a client or any other person (including money held on trust), or

- (B) held in an account of a client, or an account of another person, which is operated by a solicitor (or registered European lawyer, registered foreign lawyer, recognised body, licensed body, employee of a solicitor or registered European lawyer, or manager or employee of a recognised body or licensed body); or
- (ii) you obtain information which you have reasonable cause to believe is likely to be of material significance in determining whether a solicitor (or registered European lawyer, or registered foreign lawyer, or recognised body, or licensed body, or employee of a solicitor or registered European lawyer, or manager or employee of a recognised body or licensed body) is a fit and proper person
 - (A) to hold money for clients or other persons (including money held on trust), or
 - (B) to operate an account of a client or an account of another person,

you must immediately give a report of the matter to the Solicitors Regulation Authority in accordance with section 34(9) of the Solicitors Act 1974 or article 3(1) of the Legal Services Act 2007 (Designation as a Licensing Authority) (No. 2) Order 2011 as appropriate;

- (b) you may, and are encouraged to, make that report without prior reference to me/this firm/this company/this limited liability partnership;
- (c) you are to report directly to the Solicitors Regulation Authority should your appointment be terminated following the issue of, or indication of intention to issue, a qualified accountant's report, or following the raising of concerns prior to the preparation of an accountant's report;
- (d) you are to deliver to me/this firm/this company/this limited liability partnership with your report the completed checklist required by rule 43 of the SRA Accounts Rules 2011; to retain for at least three years from the date of signature a copy of the completed checklist; and to produce the copy to the Solicitors Regulation Authority on request;

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- (e) you are to retain these terms of engagement for at least three years after the termination of the retainer and to produce them to the Solicitors Regulation Authority on request; and
- (f) following any direct report made to the Solicitors Regulation Authority under (a) or (c) above, you are to provide to the Solicitors Regulation Authority on request any further relevant information in your possession or in the possession of your firm.

To the extent necessary to enable you to comply with (a) to (f) above, I/we waive my/the firm's/the company's/the limited liability partnership's right of confidentiality. This waiver extends to any report made, document produced or information disclosed to the Solicitors Regulation Authority in good faith pursuant to these instructions, even though it may subsequently transpire that you were mistaken in your belief that there was cause for concern."

- 35.2 The letter of engagement and a copy must be signed by **you** and by the accountant. **You** must keep the copy of the signed letter of engagement for at least three years after the termination of the retainer and produce it to the **SRA** on request.
- 35.3 The specified terms may be included in a letter from the accountant to **you** setting out the terms of the engagement but the text must be adapted appropriately. The letter must be signed in duplicate by both parties, with **you** keeping the original and the accountant the copy.

Guidance note

- (i) Any direct report by the accountant to the SRA under rule 35.1(a) or (c) should be made to the Fraud and Confidential Intelligence Bureau.

Rule 36.1: Change of accountant

- 36.1 On instructing an accountancy practice to replace that previously instructed to produce accountant's reports, **you** must immediately notify the **SRA** of the change and provide the name and business address of the new accountancy practice.

Rule 37: Place of examination

- 37.1 Unless there are exceptional circumstances, the place of examination of **your** accounting records, files and other relevant documents must be **your** office and not the office of the accountant. This does not prevent an initial electronic transmission of data to the accountant for examination at the accountant's office with a view to reducing the time which needs to be spent at **your** office.

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Rule 38: Provision of details of bank accounts, etc.

38.1 The accountant must request, and *you* must provide, details of all accounts kept or operated by *you* in connection with *your* practice at any *bank*, *building society* or other financial institution at any time during the *accounting period* to which the report relates. This includes *client accounts*, *office accounts*, accounts which are not *client accounts* but which contain *client money*, and *clients'* own accounts operated by *you* as signatory.

Rule 39: Test procedures

39.1 The accountant must examine *your* accounting records (including statements and passbooks), *client* and *trust* matter files selected by the accountant as and when appropriate, and other relevant documents, and make the following checks and tests:

(a) confirm that the accounting system in every office complies with:

- (i) rule 29 - accounting records for client accounts, etc;
- (ii) rule 30 - accounting records for clients' own accounts;

and is so designed that:

- (A) an appropriate client ledger account is kept for each *client* (or other person for whom *client money* is received, held or paid) or *trust*;
- (B) the client ledger accounts show separately from other information details of all *client money* received, held or paid on account of each *client* (or other person for whom *client money* is received, held or paid) or *trust*; and
- (C) transactions relating to *client money* and any other money dealt with through a *client account* are recorded in the accounting records in a way which distinguishes them from transactions relating to any other money received, held or paid by *you*;

(b) make test checks of postings to the client ledger accounts from records of receipts and payments of *client money*, and make test checks of the casts of these accounts and records;

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- (c) compare a sample of payments into and from the *client accounts* as shown in *bank* and *building society* or other financial institutions' statements or passbooks with *your* records of receipts and payments of *client money*, including paid cheques;
- (d) test check the system of recording *costs* and of making transfers in respect of *costs* from the *client accounts*;
- (e) make a test examination of a selection of documents requested from *you* in order to confirm:
 - (i) that the financial transactions (including those giving rise to transfers from one client ledger account to another) evidenced by such documents comply with Parts 1 and 2 of the rules, rule 27 (restrictions on transfers between clients) and rule 28 (executor, trustee or nominee companies); and
 - (ii) that the entries in the accounting records reflect those transactions in a manner complying with rule 29;
- (f) subject to rule 39.2 below, extract (or check extractions of) balances on the client ledger accounts during the *accounting period* under review at not fewer than two dates selected by the accountant (one of which may be the last day of the *accounting period*), and at each date:
 - (i) compare the total shown by the client ledger accounts of the liabilities to the *clients* (and other persons for whom *client money* is held) and *trusts* with the cash account balance; and
 - (ii) reconcile that cash account balance with the balances held in the *client accounts*, and accounts which are not *client accounts* but in which *client money* is held, as confirmed direct to the accountant by the relevant *banks, building societies* and other financial institutions;
- (g) confirm that reconciliation statements have been made and kept in accordance with rule 29.12 and 29.17(a);
- (h) make a test examination of the client ledger accounts to see whether payments from the *client account* have been made on any individual account in excess of money held on behalf of that *client* (or other person for whom *client money* is held) or *trust*;
- (i) check the office ledgers, office cash accounts and the statements provided by the *bank, building society* or other financial institution for any *office*

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account maintained by *you* in connection with the practice, to see whether any *client money* has been improperly paid into an *office account* or, if properly paid into an *office account* under rule 17.1(b) or rule 19.1, has been kept there in breach of the rules;

- (j) check the accounting records kept under rule 29.17(d) and 29.19 for *client money* held outside a *client account* to ascertain what transactions have been effected in respect of this money and to confirm that the *client* has given appropriate instructions under rule 15.1(a);
- (k) make a test examination of the client ledger accounts to see whether rule 29.10 (accounting records when acting for both lender and borrower) has been complied with;
- (l) for liquidators, trustees in bankruptcy, *Court of Protection deputies* and trustees of occupational pension schemes, check that records are being kept in accordance with rule 29.15, 29.17(c) and 29.20, and cross-check transactions with *client* or *trust* matter files when appropriate;
- (m) check that statements and passbooks and/or duplicate statements and copies of passbook entries are being kept in accordance with rule 29.17(b)(ii) and 29.21 (record-keeping requirements for joint accounts), and cross-check transactions with *client* matter files when appropriate;
- (n) check that statements and passbooks and/or duplicate statements, copies of passbook entries and cheque details are being kept in accordance with rule 30 (record-keeping requirements for clients' own accounts), and cross-check transactions with *client* matter files when appropriate;
- (o) for money withdrawn from *client account* under rule 20.1(j), check that records are being kept in accordance with rule 29.16, 29.17(a) and 29.22, and cross-check with *client* or *trust* matter files when appropriate;
- (p) in the case of private practice only, check that for the period which will be covered by the accountant's report the *firm* was covered for the purposes of the *SRA's* indemnity insurance rules in respect of its offices in England and Wales by:
 - (i) certificates of qualifying insurance outside the assigned risks pool;
or
 - (ii) a policy issued by the assigned risks pool manager; or
 - (iii) certificates of indemnity cover under the professional requirements of an *REL's* home jurisdiction in accordance with paragraph 1 of

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Appendix 3 to those rules, together with the **SRA's** written grant of full exemption; or

- (iv) certificates of indemnity cover under the professional requirements of an **REL's** home jurisdiction plus certificates of a difference in conditions policy with a qualifying insurer under paragraph 2 of Appendix 3 to those rules, together with the **SRA's** written grant of partial exemption; and
- (q) ask for any information and explanations required as a result of making the above checks and tests.

Extracting balances

39.2 For the purposes of rule 39.1(f) above, if **you** use a computerised or mechanised system of accounting which automatically produces an extraction of all client ledger balances, the accountant need not check all client ledger balances extracted on the list produced by the computer or machine against the individual records of client ledger accounts, provided the accountant:

- (a) confirms that a satisfactory system of control is in operation and the accounting records are in balance;
- (b) carries out a test check of the extraction against the individual records; and
- (c) states in the report that he or she has relied on this exception.

Guidance notes

- (i) The rules do not require a complete audit of your accounts nor do they require the preparation of a profit and loss account or balance sheet.
- (ii) In making the comparisons under rule 39.1(f), some accountants improperly use credits of one client against debits of another when checking total client liabilities, thus failing to disclose a shortage. A debit balance on a client account when no funds are held for that client results in a shortage which must be disclosed as a result of the comparison.
- (iii) The main purpose of confirming balances direct with banks, etc., under rule 39.1(f)(ii) is to ensure that your records accurately reflect the sums held at the bank. The accountant is not expected to conduct an active search for undisclosed accounts.

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- (iv) In checking compliance with rule 20.1(j), the accountant should check on a sample basis that you have complied with rule 20.2 and are keeping appropriate records in accordance with rule 29.16, 29.17(a) and 29.22. The accountant is not expected to judge the adequacy of the steps taken to establish the identity of, and to trace, the rightful owner of the money.

Rule 40: Departures from guidelines for accounting procedures and systems

40.1 The accountant should be aware of the **SRA's** guidelines for accounting procedures and systems (see rule 26), and must note in the accountant's report any substantial departures from the guidelines discovered whilst carrying out work in preparation of the report. (See also rule 41.1(e).)

Rule 41: Matters outside the accountant's remit

41.1 The accountant is not required:

- (d) to extend his or her enquiries beyond the information contained in the documents produced, supplemented by any information and explanations given by **you**;
- (e) to enquire into the stocks, shares, other securities or documents of title held by **you** on behalf of **your clients**;
- (f) to consider whether **your** accounting records have been properly written up at any time other than the time at which his or her examination of the accounting records takes place;
- (g) to check compliance with the provisions in rule 22 on **interest**, nor to determine the adequacy of **your interest** policy;
- (h) to make a detailed check on compliance with the guidelines for accounting procedures and systems (see rules 26 and 40); or
- (i) to determine the adequacy of the steps taken under paragraphs (a) and (b) of rule 20.2.

Rule 42: Privileged documents

42.1 When acting on a **client's** instructions, **you** will normally have the right on the grounds of privilege as between **solicitor** and **client** to decline to produce any document requested by the accountant for the purposes of his or her examination.

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In these circumstances, the accountant must qualify the report and set out the circumstances.

Guidance note

- (i) In a recognised body or licensed body with one or more managers who are not legally qualified, legal professional privilege may not attach to work which is neither done nor supervised by a legally qualified individual - see Legal Services Act 2007, section 190(3) to (7), and Schedule 22, paragraph 17.

Rule 43: Completion of checklist

43.1 The accountant should exercise his or her professional judgment in adopting a suitable "audit" programme, but must also complete and sign a checklist in the form published from time to time by the **SRA**. **You** must obtain the completed checklist, retain it for at least three years from the date of signature and produce it to the **SRA** on request.

Guidance notes

- (i) The current checklist appears at Appendix 4. It is issued by the SRA to firms at the appropriate time for completion by their reporting accountants.
- (ii) The letter of engagement required by rule 35 imposes a duty on the accountant to hand the completed checklist to the firm, to keep a copy for three years and to produce the copy to the SRA on request.

Rule 44: Form of accountant's report

44.1 The accountant must complete and sign his or her report in the form published from time to time by the **SRA**. An explanation of any significant difference between liabilities to **clients** and **client money** held, as identified at section **24** of the report, must be given by either the accountant or **you**.

Guidance notes

- (i) _____ The current form of accountant's report appears at Appendix 5. The report confirms if the accountant has found it necessary to qualify the report. If so, the report must -be delivered to the SRA - see rule 32.1(b) and guidance note (i) to that rule.

(i) _____

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- (ii) ~~The form of report is prepared and issued by the SRA to firms at the appropriate time for completion by their reporting accountants.~~ Separate reports can be ~~obtained delivered~~ for each principal in a partnership but most firms ~~choose to obtain deliver~~ one report in the name of all the principals. ~~In either case, the report must be delivered to the SRA if it is qualified - see rule 32.1(b) and guidance note (i) to that rule.~~ For assistant solicitors, consultants and other employees, see rule 32, guidance notes (vii) and (viii).
- (iii) An incorporated practice will ~~obtain deliver~~ only one report, on behalf of the company and its directors, or on behalf of the LLP and its members - see rule 32.1. ~~The report must be delivered to the SRA if it is qualified - see rule 32.1(b) and guidance note (i) .~~
- (iv) Although it may be agreed that the accountant send ~~any qualified the reports~~ direct to the SRA, the responsibility for delivery is that of the firm. The form of report requires the accountant to confirm that ~~either~~ a copy of the report (~~whether qualified or unqualified~~) has been sent to ~~the COFA on behalf of the firm to which it relates. and it is part of the~~ The COFA should ensure that the report is seen by each of the managers of the firm. each of the persons (including bodies corporate) to whom the report relates, or a copy of the report has been sent to a named partner on behalf of all the partners in the firm. A similar confirmation is required in respect of the directors of a recognised body/licensed body which is a company, or the members of a recognised body/licensed body which is an LLP.
- (v) A reporting accountant is not required to report on trivial breaches due to clerical errors or mistakes in book-keeping, provided that they have been rectified on discovery and the accountant is satisfied that no client suffered any loss as a result.
- ~~(vi)~~ — In many practices, clerical and book-keeping errors will arise. In the majority of cases these may be classified by the reporting accountant as trivial breaches. However, a "trivial breach" cannot be precisely defined. The amount involved, the nature of the breach, whether the breach is deliberate or accidental, how often the same breach has occurred, and the time outstanding before correction (especially the replacement of any shortage) are all factors which should be considered by the accountant before deciding whether a breach is trivial.

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~~(vii)(vi) Accountants' reports should be sent to the Information Directorate.~~

~~(viii)(vii)~~ For direct reporting by the accountant to the SRA in cases of concern, see rule 35 and guidance note (i) to that rule.

Rule 45: Firms with two or more places of business

45.1 If a *firm* has two or more offices:

- (a) separate reports may be delivered in respect of the different offices; and
- (b) separate *accounting periods* may be adopted for different offices, provided that:
 - (i) separate reports are delivered;
 - (ii) every office is covered by a report delivered within six months of the end of its *accounting period*; and
 - (iii) there are no gaps between the *accounting periods* covered by successive reports for any particular office or offices.

Rule 46: Waivers

46.1 The *SRA* may waive in writing in any particular case or cases any of the provisions of Part 6 of the rules, and may revoke any waiver.

Guidance note

- (i) Applications for waivers should be made to the SRA Information Directorate. In appropriate cases, firms may be granted a waiver of the obligation to obtain-deliver an accountant's report (see rule 32, and guidance note (xi) to that rule). The circumstances in which a waiver of any other provision of Part 6 would be given must be extremely rare.