APPLICATION MADE BY THE SOLICITORS REGULATION AUTHORITY BOARD TO THE LEGAL SERVICES BOARD UNDER PART 3 OF SCHEDULE 4 TO THE LEGAL SERVICES ACT 2007 FOR THE APPROVAL OF THE SRA AMENDMENT TO REGULATORY ARRANGEMENTS (ACCOUNTANTS' REPORTS AND OVERSEAS RULES) RULES 2015

A. *PROPOSED ALTERATIONS*

1. Rule 2 of the SRA Amendments to Regulatory Arrangements (Accountants' Reports and Overseas Rules) Rules 2015 ('the Rules') makes changes to the SRA Accounts Rules 2011 ('SAR') to (a) extend the category of firms exempt from the requirement to obtain an accountant's report (b) abolish the prescriptive testing procedures where accountants' reports are still required and (c) amend the form of accountant's report. These changes relate to what are referred to in this document as the 'domestic requirements'.

2. Rules 1, 3 and 4 of the Rules make changes to the application of accounts rules to SRA authorised bodies with subsidiary or branch legal practices in other jurisdictions ('responsible authorised bodies') and through them to overseas practices themselves.

3. The changes are made to the SAR, the SRA Overseas Rules 2013 ("the Overseas Rules"), and to the SRA Glossary 2011.

4. Part 7 of the SAR is also amended to maintain the application of a proportionate regime to Registered European Lawyers ('RELs') practising in England and Wales through Exempt European Practices ('EEPs'), which are not SRA authorised and do not conduct reserved activities.

5. If approved, the changes will come into effect on 1 November 2015 in accordance with Rule 5.

6. The relevant SRA Board papers can be found at http://www.sra.org.uk/sra/how-we-work/board/public-meetings/archive/15-jul-2015.page

B. *NATURE AND EFFECT OF THE SRA'S CURRENT ARRANGEMENTS*

7. Through the SAR (rule 32.1), we require firms holding client money to obtain an accountant's report on an annual basis relating to their compliance with the requirements of the SAR, and to submit this to us if it is qualified. From 31 October 2014 we introduced an exemption from the reporting requirements for the small number of firms which receive 100% of their client money from Legal Aid Agency work (rule 32.1A).

8. The prescribed testing required to prepare the accountant's report and the form of the report itself are currently specified in Part 6 of the SAR (rules 39-44).

9. The accounts rules which currently apply to overseas practices are contained within Part 7 of the SAR. These rules cover four issues: the payment of interest (rule 49); the holding and treatment of client money (rule 50.3); the preparation and submission of accountants' reports (rules 50.4-50.6); and the production of information at the SRA's request (rule 51). Each rule is prefaced with different application rules and the glossary definitions employed (e.g. for *client money (overseas)*) are significantly different to those used for domestic purposes.

10. Part 7 was amended in April 2015, to apply to Registered European Lawyers (RELs) practising from an office in England and Wales of an Exempt European Practices (EEPs), which are bodies not authorised by the SRA. This change was intended to ensure that the SRA could hold individual RELs responsible for any client money which they handle in that capacity.

C. NATURE AND EFFECT OF THE PROPOSED AMENDMENTS TO THE CURRENT ARRANGEMENTS

11. A copy of the SRA Amendments to Regulatory Arrangements (Accountant's Reports and Overseas Rules) Rules2015] is attached as **Annex 1.** Schedule 2 of which is the SAR with the tracked changes it is proposed are now made and Schedule 3 is the Overseas Rules similarly marked.

Domestic requirements

12. Our principal proposal is to amend the SAR and the format of the accountant's report to remove the current detailed requirements on the amount of prescribed testing that is required to assess compliance with the SAR and instead to allow accountants to exercise their professional judgment in relation to the matters they report – see new SAR 38 replacing old SAR 39.

13. The new form of report which reflects this approach is set out at Annex 3 –see also new SAR 40.

14. Another aspect of our proposed change to the SAR relates to low risk firms. As stated above, we have already (from 31 October 2014) introduced an exemption from the reporting requirements for the small number of firms which receive 100% of their client money from Legal Aid Agency work. We propose that, on the basis of the low risks presented, that we should also exempt firms which hold an average client account balance of no more than £10,000 and a maximum balance of no more than £250,000 within the relevant accounting year –see new SAR 32.1A and 32.1B.

15. This proposal would exempt around 13% of firms who report holding client money. SAR 32.2 give us the right to require individual firms (including, in future, those within the exempted category) to obtain and/or submit accountants' reports. We will also retain the requirement that all firms (including those that will be otherwise exempted) which close down or otherwise cease to hold client money should obtain a 'ceasing to hold accountant's report' to ensure that they have properly accounted for all client money – see new SAR 33.5 (old SRA 33.5).

Overseas Rules

16. In the Overseas Rules we are proposing the following changes:

i) Amendments to clarify that the new provisions in the Overseas Rules relating to client monies must be complied with, alongside any local regulatory requirements, and that these flow from Overseas Principle 10 (relating to client money and assets);

ii) A new Overseas Rule 5, which sets out eight basic requirements on the handling of client money. This rule preserves the key content of the existing provisions in Part 7 of SAR, but removes some of the qualifying detail which cause compliance issues for overseas offices, where there are conflicting local requirements;

iii) The addition of Overseas Rules 6.3 and 6.5 expanding on existing reporting requirements which require reporting of material or systemic breaches of the Overseas Principles to the SRA (previously Overseas Rule 3, now Rule 6). The additional provisions relating to overseas accounts enable the SRA to specifically request the submission of an accountant's report in relation to any client money held by an overseas practice if that is appropriate.

iv) The deletion of the commencement provisions in the Overseas Rules as these are no longer relevant.

17. We are also proposing:

(i) The inclusion in the amendment regulations of a provision covering transitional arrangements for accountants' reports from overseas offices (Rule 4). This will clarify requirements on the submission of any reports that are outstanding or expected before the entry into force of the new rules, but remove the automatic reporting requirement for subsequent periods;

(ii) Changes to the Glossary definitions of *client money overseas, client account (overseas)* and *office money (overseas)*. This will bring these terms into line with domestic definitions whilst reflecting the differences in terminology and need to avoid references specific to the domestic jurisdiction (for example, stamp duty land tax, Land Registry registration fees, and PAYE).

ii. Client Account of RELs practising in Exempt European Practices

18. In April 2015, the SRA introduced a rule change to permit RELs to practise in bodies that are not authorised subject to certain conditions including that they are not conducting reserved activities. The rule change enabled European law firms to establish in England and Wales as non-authorised bodies (Exempt European Practices or EEPs) subject to these conditions thus treating European law firms in the same way as foreign law firms in this respect. In order to ensure that any client money held by a REL working in an EEP is subject to an appropriate level of protection, Part 7 of the SAR was extended to apply to RELs practising in this way. However, in the vast majority of cases, given the kind of work undertaken by EEPs[1], RELs will not be holding client money.

19. We are proposing to amend Part 7 which will henceforth only apply to RELs working in EEPs. The requirements in this section on the handling of client money will mirror the rules relating to the handling of client money by solicitors practising overseas

[1] Most of those firms which have expressed an interest in EEP status are representative offices of larger European law firms present in London in order to represent their clients in the City of London.

(overseas rule 5.1). In other words, a principled regime will apply which makes it clear that client money and assets must be protected, but which will not impose detailed requirements, since our Handbook will not apply to the bodies in which these individuals are working. However, the amendments to Part 7 will parallel domestic provisions on obtaining and delivering accountants reports (as set out in Part 6 of the SAR). This will require RELs in EEPs who do hold client money to be subject to the same reporting requirements as solicitors. We consider that this approach is justified because RELs working in EEPs are established in England and Wales and subject to our code of conduct. It is therefore reasonable to apply the same approach to them as to other authorised persons, whilst reflecting that they work in entities that are outside our control.

D. RATIONALE FOR THE PROPOSED AMENDMENTS

Domestic requirements

20. Our protection of client money requires rules which balance a proper degree of oversight and control with ensuing that the regulatory burdens we impose are necessary and proportionate.

21. Under the SAR, over 9,000 accountants' reports are carried out annually and over 50% of them are qualified and submitted to the SRA: reports may be qualified for a range of reasons, including trivial breaches which do not cause significant adverse impact on clients. From the total number of qualified reports received annually, around 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.

22. Although the SAR provide that accountants do not need to report on trivial breaches, our experience to date is that the qualified reports we receive often do not reveal any significant risk to client monies. This is partly due to the level of detail prescribed in the SAR and in the nature of the test procedures these prescribe, which mean that accountants are not able to exercise their professional judgment in adopting a suitable work programme and in deciding only to notify us of significant areas of concern

23. The amendments to the SAR and the format of the accountant's report to remove the current rigid requirements on the amount of prescribed testing that is required to assess compliance with the Accounts Rules will allow accountants to exercise their professional judgment in relation to the matters they report. Our view is that this approach will lead to fewer firms having their accounts qualified for trivial breaches, focusing the reports on issues that present a real risk to client money.

24. Guidance to the revised SAR (see Annex 4) sets out our new approach, namely that reports should only be qualified where the breaches identified are material and are therefore likely to put client money at risk. The guidance clarifies that, whilst we recognise that trivial breaches of the SAR do occur in many firms, we are not expecting all identified breaches to be notified to us in the form of a qualified report.

25. The guidance also provides assistance to accountants in deciding when breaches are material and when reports should be qualified, and sets out indicative factors indicating a significant weakness in the firm's systems and controls, such as a significant and/or unreplaced shortfall on a client account. The guidance also includes a table setting out particular checks and controls that the accountant might

wish to perform if appropriate for the firm, highlighting 'best practice', 'adequate practice' and 'below adequate practice'. 'Below adequate practice' could lead to qualification, depending whether there is a risk to client money. The 'best practice' element of the guidance can assist firms in benchmarking their accounting processes and making improvements.

26. Another key aspect of proportionate regulation is that we reflect the lower risks posed by firms holding only small amounts of client money.

27. Our consultation also proposed to extend the current exemption from the reporting requirements to those who hold an average balance of client account of less than £10,000, based on the risk they present to client funds.

28. We carried out an analysis of client money information supplied by firms as part of the Practising Certificate Renew Exercise (PCRE) in autumn 2014 which includes average, maximum and minimum balances. This exercise demonstrated that the proposed category of firms that have a £10,000 or less average client account balance over the year includes some firms that hold very significant maximum amounts of client money, potentially on a one-off basis, including some firms with a maximum over £1 million.

29. We therefore proposed an additional measure of a maximum client balance of no more than £250,000 at any reconciliation point during the accounting year as it links clearly to the impact of any failures. We made a number of comparison of the relevant risks posed by this sample group of firms compared with the general population of firms that hold client money[2] - see section E below..

30. Our conclusion overall is that the sample firms are significantly lower risk in areas relating to client money and accountant's reports than the general population of firms that hold client money. We recognise that this does not mean that as a category these firms are entirely risk free. However, we consider that the risk is at a tolerably low level. No system can provide a guarantee of 100% client protection – and indeed to do so would disproportionately increase the costs of regulation and therefore act as a barrier to firms entering the market and/or increase costs to consumers. The aim must be to ensure any safeguards or requirements are appropriately targeted at areas of highest risk, both in terms of the likelihood of that risk materialising and the nature of any harm that might result. The maximum client account levels we have proposed will limit the degree of harm that can arise in exempted firms. Further, we note that other consumer protections exist (such as compulsory professional indemnity insurance and the compensation fund, should risks materialise).

31. It is worth highlighting that SAR 32.2 gives us the right to require individual firms (including, in future, those within the exempted category) to obtain and/or submit accountants' reports. Reported matters and other intelligence will lead us to investigate individual firms where needed and to intervene or impose immediate conditions requiring them to obtain reports on an annual or more frequent basis if the risk posed requires such action. Some practitioners are already subject to special reporting requirements by virtue of conditions on their practising certificates and these requirements will remain in place even if the firm within which they work would otherwise be within the exempted category.

Overseas Rules

[2] Firms that do not hold client money were excluded from the analysis.

32. A major driver for changing the overseas accounts rules has been the request from a number of firms with overseas offices for the SRA to bring its approach to overseas accounts into line with its broader approach to regulation overseas. In our various consultations, both formal and informal, it has been made clear to us that firms find the application rules in Part 7 of the SRA Accounts Rules complex and cumbersome to administer. This complexity was introduced in order to prevent overseas branch offices of English firms having to apply the Accounts Rules in circumstances in which there were no solicitors in these offices. However, this makes the rules difficult to understand and has generated many enquiries on their interpretation and requests for waivers. It has also resulted in the application of the rules to overseas offices changing simply because the composition of the management of that office has changed. There is therefore significant scope for simplification in the application of these rules.

33. In addition, firms with offices in multiple jurisdictions have also complained that the current Part 7 SAR rules result in a different application across their network of offices, making it harder to roll out a consistent compliance approach. Under our proposed new approach, all overseas offices under the control of an SRA authorised 'responsible authorised body'[3] would be covered by the same accounts rules. Although this broadens the application of our accounts rules, it does so on a principles based approach, following the approach adopted in the Overseas Rules generally. This, in our view, gives the SRA the appropriate level of oversight outside England and Wales, and allows those authorised in England and Wales to be held responsible for any failure to protect client money or assets, whilst avoiding the burden of dual regulation or the inadvertent export of the detail of our accounts rules.

34. The changes to Part 7 SAR reflect the move of the accounts rules relating to overseas practices to the Overseas Rules. Part 7 cannot be deleted in its entirety as it also applies to RELs practising from the office of an EEP and will henceforth only apply to these individuals. This means that the remaining Part 7 can be significantly simplified by the removal of much of the detail in the application rules. In essence, what remains in Part 7 relating to the handling of client money is a simplified version of the existing provisions in Part 7 of SAR. The amendment results in the domestic provisions in Part 6 SAR relating to accountants' reports also applying to RELs working in EEPs in an office in England and Wales. RELs working in EEPs who handle client money in England and Wales will therefore be required to submit accountant's reports unless they are exempt. The rationale for these changes is the need to have some rules covering circumstances in which RELs might hold money for clients, and therefore still be covered by SRA protections, even if they are operating from an EEP, but to keep these requirements proportionate.

E. STATEMENT IN RESPECT OF THE REGULATORY OBJECTIVES

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35. This statement comprises an assessment of the reforms to the SAR and Overseas Rules as against our regulatory objectives, our public sector equality duty and the better regulation principles in respect of both the domestic requirements and the Overseas Rules.

Protecting and promoting public interest

[3] A responsible authorised body is the authorised body in England and Wales which is held accountable under O (7.11) of the SRA Code of Conduct for any overseas practices under its control.

36. It is in the public interest that SRA regulated firms and individuals account for client money correctly, but that any regulation is proportionate so as not to unduly restrict the growth, cost and availability of legal services. The proposed rule changes will achieve this by focusing on risks to client's money, rather than on technical breaches of the Accounts Rules. In the case of the Overseas Rules changes firms will be able to run single compliance regimes across their networks and the SRA will be in a position to have a better understanding of how firms are managing their international operations as a result.

Supporting the constitutional principle of the rule of law

37. We do not consider that these reforms will have a significant impact on this objective – either on the independence of the SRA or of the legal professionals that we regulate. The changes to the accounts rules governing RELs in EEPs are not material alterations from the current regime and are consequential on changes to rules relating to overseas practices and the domestic reporting arrangements. They do not therefore represent any change to practice rights in England and Wales.

Improving access to justice

38. Whilst individually reducing or removing the costs to firms of accounting reports will have a limited effect, the reforms to the SAR form part of an overall package to reduce the burden of regulation on SRA regulated firms. Lower operating costs may translate into more competitive price offers thus increasing access to services. However the primary aim of these changes is to allow both firms and the SRA to get better value from the accountant's reports process itself. Some firms may choose to use the new flexibility to obtain more tailored reports which will not necessarily be any cheaper (and may be more expensive) than the previous reports.

39. We do not consider that the proposed changes to the Overseas Rules will have any impact on access to justice in England and Wales, given that the changes will largely be relevant only to overseas practice.

Protecting and promoting the consumer interest

40. Focussing accountant's reports on risks to client money will ensure that the SRA receives more targeted information, which will help in identifying those cases where action needs to be taken to protect consumers.

41. There are a number of protections for consumers built in to the process.

42. Accountants have a duty to notify the SRA directly if there is evidence of theft or fraud or significant concerns about the fitness and propriety of the firm to hold client money. As part of these reforms we have added to this a duty to notify the SRA if the accountant finds that a previously qualified report has not been submitted to us.[4]

43. We carried out modelling to look at risk before deciding on the categories of firm that were going to be exempted from the requirement to obtain a report.

44. We made a number of comparisons of the relevant risks posed by the exempted firms compared to 'all firms' - the general population of firms that hold client money[5].

45. First we looked at matters received narrowly connected with accountant's reports. This incorporated breaches of Accounts Rules including items such as improper use

[4] See Rule 35.1

[5] Firms that do not hold client money were excluded from the analysis.

of a suspense ledger, no accounting records, wrongful transfer of costs and unjustified client account shortages.

46. 14.6 % of all firms had a matter received against them in the two year period in this category, whilst the proportion was 7.4% for exempted firms.

47. Most matters are not upheld (i.e. we do not consider that the allegation is made out) so we then looked at upheld matters only. Whilst 0.7% of all firms had an upheld matter against them in this category in the two year period, the proportion was lower for exempted firms (0.2%). Exempted firms were 7% less likely to have an upheld matter against them in this category.

48. We then looked at a wider definition of financial matters reported over the last 5 years. This definition included all those in the narrow definition but adding misappropriation, money laundering and financially related frauds as well late accountant's reports, and other issues connected to the process of filing reports such as failing to file.

49. Using this wider definition, 3.5% of all firms have had upheld matters against them in the five year period compared to 1.6% of exempted firms having such upheld matters. Exempted firms were 59% less likely to have a historic risk in these areas.

50. We then looked at the frequency of qualified accountants reports received under the current system. We did not consider that this could be used as a direct criterion since the majority of reports were qualified for minor issues that led to us taking no further action. However, it was seen as indicative that whilst 58.8% of all firms (open for at least two years) had filed qualified accounts in a two year period, the proportion amongst exempted firms was much lower at 37%.

51. We also examined other contextual characteristics of firms that were classed as exempted. As well as having notably lower client balances, exempted firms also had lower numbers of personnel and turnover.

52. Our conclusion overall is that exempted firms are significantly lower risk in areas relating to client money and accountant's reports than the general population of firms that hold client money. This does not mean that as a category these firms are entirely risk free – but we are satisfied that the risk is at a low level and that given that other consumer protections such as compulsory professional indemnity insurance exist it is not appropriate to continue to impose a blanket requirement to obtain a report.

53. The Accounts Rules retain the right for the SRA to require individual firms within the exempted category to file accountant's reports. Reported matters and other intelligence will allow us to investigate individual firms where needed. Some practitioners are already subject to special accounting report requirements by virtue of conditions on their certificate and these requirements will remain in place even if the firm would otherwise be within the exempt category.

54. We have retained the requirement that all firms (including those that will be otherwise exempt) who close down or otherwise cease to hold client money should obtain a 'ceasing to hold report' to ensure that they have properly accounted for client money.

55. Our proposals in relation to the Overseas Rules are unlikely to have a major impact on consumers. The vast majority of business transacted by overseas practices is for

business clients (as opposed to legal work for UK residents instructing England and Wales based solicitors to act for them in another jurisdiction). The rule changes proposed however, do not significantly reduce the protections or the principles relating to handling of client money overseas and the changes to the reporting requirements are unlikely to reduce our knowledge of whether client money overseas has been mishandled, it will simply alter the mechanism through which this happens, from a local accountant's report to a report from the responsible authorised body. The position governing RELs working in EEPs is not significantly changed from current requirements.

Promoting competition in the provision of services provided by authorised persons

56. Allowing accountants reports to be tailored for factors such as size and structure will benefit firms when compared to a' one size fits all' rule. Over time, when the exemption of certain firms from the requirement is taken into account, we believe this should reduce the cost burden on firms. However, it may be the case that there are transitional costs whilst accountants and firms become used to new procedures. It would not be possible to model these, as this will vary by firm:

- some firms will now be exempted from the requirement to obtain reports so they can save the full cost of the report;
- some firms will continue with their current procedures;
- some firms will agree with accountants to carry out less testing than before; and
- other firms will ask accountants to carry out more work and take advantage of the new flexibility to improve procedures.

57. However there are a number of factors that will mitigate any transitional costs.

58. There are no changes to the Accounts Rules in relation to how firms should treat client money. This means that firms do not have to design new internal accounting procedures to accommodate the reforms.

59. Instead the new approach is intended to achieve two results. Firstly, it means that reporting accountants will not feel obliged to qualify reports for non-material breaches to the Accounts Rules that do not put client money at risk.

60. Secondly it provides discretion as to how to measure whether the Accounts Rules are complied with. We are no longer prescriptive in terms of how the accountant must assess that compliance. We have provided guidance on how they might wish to do so in accordance with their professional judgment. If firms wish to agree with their accountants that it is appropriate to continue using the old sampling method as a way of carrying out that assessment they are free to do so.

61. However, firms and accountants now have the flexibility to take a different approach if they feel this will be of benefit. This could include smaller samples (and therefore lower costs) where that is justified, or a more focused report if the firm wanted to use it as an opportunity to improve its processes.

62. The changes proposed to the Overseas Rules will create more of a level playing field for firms with offices in other jurisdictions, since all will now be subject to the same

rules. The changes will, however, reduce the costs to firms of establishing and maintaining a network of offices in other jurisdictions, since they will no longer be subject to the requirement to submit an accountant's report in the form required by the SRA, which in some instances duplicates local requirements (though not in exactly the same format). We therefore anticipate that cost will be removed from compliance requirements for many firms, and as an example, one firm with a large network of offices has calculated that the removal of duplicate local and SRA reporting requirements will save it around £0.5 million per year. The removal of such costs from the system will enable firms to operate more competitively internationally.

Encouraging an independent, strong, diverse and effective legal profession

63. Although individual firms will now be able to tailor reports as set out above, the largest cost impact is likely to come in the cost savings for those firms that will be exempt from obtaining a report. We understand from practitioners that a small firm may pay around £800 for each annual accountant's report, but that larger firms may pay several thousand pounds.

64. These changes will particularly benefit smaller firms – of the 1014 firms identified in our analysis[6] that would have been exempted from the requirement to obtain a report under the new criteria ('exempted firms'), 835 (82%) meet the small firms definition.[7]

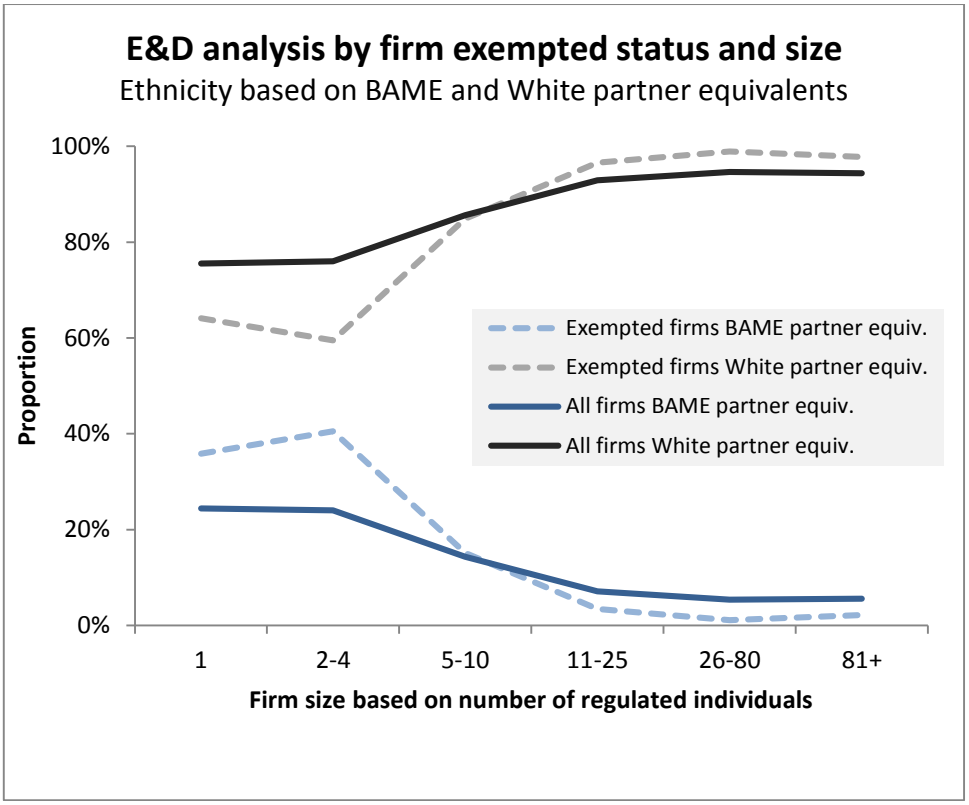
65. We looked at the ethnicity and gender breakdowns of both all regulated individuals and partner equivalents working at firms that are exempted and compared them with firms that are not exempted. The following tables summarise findings based on partner equivalents which we consider to be the most relevant measure in this case.

Ethnicity

	Partner equivalent individuals at firms that are not 'exempted firms'	Partner equivalent individuals at 'exempted firms'	Total
BAME	9% / 2877	21% / 430	9% / 3307
White	77% / 25667	65% / 1323	76% / 26990
Unknown	15% / 4859	14% / 276	14% / 5135
Total	100% / 33403	100% / 2029	100% / 35432

66. Interpretation: 21% of all partner equivalents who work at exempted firms have BAME ethnicity. This compares to 9% of all partner equivalents who work at firms that are not exempted who have BAME ethnicity. The graph below examines these figures in the context of firm size.

[6] Based on a wider dataset of firms comprising all firms in 2014 PCRE who held client money
[7] Based on whether a firm is a sole practitioner or has four or less partners AND has turnover under £400,000



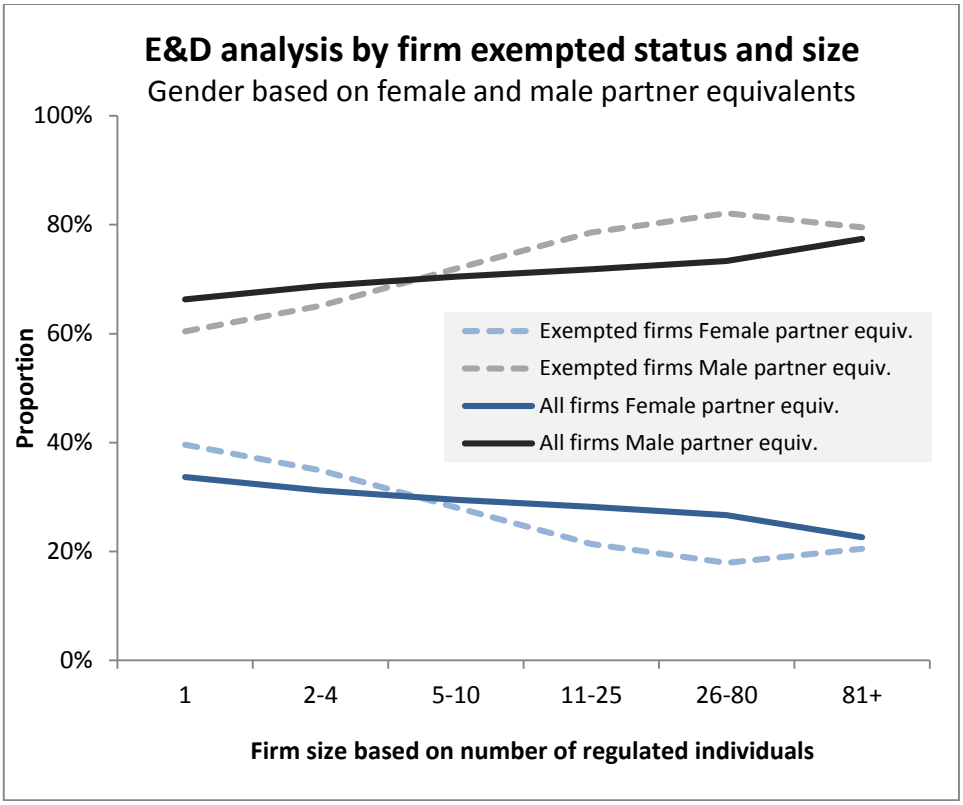
67. After taking unknowns out of the equation, we can see how size of firm is a factor affecting the ethnicity of individuals who work within exempted firms. However it also suggests that in the smallest (by number of regulated individuals) exempted firms BAME partner equivalents are more highly represented than across all of the smallest firms.

Gender

	Partner equivalent individuals at firms that are not 'exempted firms'	Partner equivalent individuals at 'exempted firms'	Total
Female	26% / 8698	30% / 612	26% / 9310
Male	72% / 23983	69% / 1410	72% / 25393
Unknown	2% / 722	0% / 7	2% / 729
Total	100% / 33403	100% / 2029	100% / 35432

68. Interpretation: 30% of the partner equivalents that work at exempted firms are female. This is a slightly higher proportion than the 26% of partner equivalents at non-exempted firms who are female.

69. The graph below examines these figures in the context of firm size.



70. Taking unknowns out of the equation, we can see that firm size - as measured by the number of regulated individuals at a firm - has an effect on gender split based on whether a firm is exempt. For all firms and for the exempt firms the distribution shows a steady increase in the proportion of partner equivalent males as the size of firm increases.

71. Our assessment in relation to partner equivalents with disability showed a marginal difference in partner equivalents with a disability in exempted firms compared to all firms.

72. Overall, we consider that these reforms are likely to promote diversity by reason of the benefit of the savings impacting mostly on smaller firms.

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34. The creation of more proportionate accounts requirements for overseas offices may make it easier for smaller firms to establish and maintain overseas offices. BAME firms generally make up a higher proportion of smaller firms.

Increasing public understanding of citizens' legal rights and duties

73. We do not consider these measures will have a significant impact on this objective one way or the other.

Promoting and maintaining adherence to professional principles by authorised persons

74. Focusing the reports on the substantive risks to client money and on the professional opinion of the accountant rather than a rigid technical sampling process and technical breaches will tend to promote the professional principles. The new best practice guidelines, whilst not compulsory, will provide firms with the opportunity to improve their accounting practices in relation to client money.

75. By bringing the obligations in relation to overseas accounts into the main body of the Overseas Rules, we believe that a stronger connection is made to the professional principles.

F. STATEMENT IN RESPECT OF THE BETTER REGULATION PRINCIPLES

76. The SRA considers that the alterations requested fulfil our obligation to have regard to the Better Regulation Principles, under section 28 of the Legal Services Act.

Transparent

77. The publication of the guidance will provide transparency in relation to the way in which the new regime for domestic providers will operate.

78. The current application of the accounts rules for overseas practices is very complex and difficult to understand. We therefore consider that by applying a uniform approach to all SRA overseas practices, regardless of the composition of their ownership, the obligations applying to overseas practices will be made much more transparent. In addition, the need to grant a significant number of waivers to ABSs has also left its application in an unclear position. By removing restrictions on ownership and focussing on client protection we consider that the rule will be more transparent.

Accountable

79. The proposals ensure that those that we regulate are fully accountable for significant breaches of the SAR.

80. Our proposals remove unnecessary burdens from our regulated community. As such, we are exercising our regulatory powers in an accountable way.

81. The accountability of firms for their overseas practices will be enhanced through the incorporation of the accounts rules into the main body of the Overseas Rules, since this requires *responsible authorised bodies* to ensure the compliance of their overseas offices with the overseas accounts rules. The current application is unpredictable and patchy and depends on the status of any particular overseas office.

Proportionate

82. The domestic requirements significantly increase proportionality by focussing accounting reports on issues of real risk to client money, and by removing the obligation to prepare the report from firms that will represent a lower risk and impact on client money.

83. Although the changes proposed widen the application of the SRA's rules to all types of overseas practices, from the current application which depends on the ownership composition of any individual office, we believe the changes are proportionate. In future, although application will be wider, it will be more principle based and focus on the essential requirements for protecting client money.

Consistent

84. The domestic requirements will bring the SAR in line with other provisions in the SRA Handbook, in that breaches should only be reported if they are material. Any

risk that accountants may exercise judgment inconsistently will be reduced by (a) the guidance provided and (b) by the SRA taking a proportionate and consistent approach to enforcement

85. The replacement of complex application requirements covering overseas practices will allow for a much more predictable and consistent application of the overseas accounts rules.

Targeted

86. Removing the requirement to obtain a report from low risk and low impact firms (as far as client money is concerned) results in a much more targeted regulatory regime, as does focussing accountants' reports on material risks to client's money.

87. In future, the requirement on firms with overseas practices to submit accountants' reports will be more targeted. The SRA will only require reports in relation to overseas offices where there it has a reason for concern about the protection being afforded to client monies or where concerns have been raised by the parent *responsible authorised body*.

G. STATEMENT IN RELATION TO DESIRED OUTCOMES

88. The changes are being made in accordance with the programme of reform set out in the SRA Board's recent policy statement "Approach to regulation and its reform" and in particular, the objective of reducing unnecessary regulatory burdens and cost on regulated firms.

H. STATEMENT IN RELATION TO IMPACT ON OTHER APPROVED REGULATORS

89. There are no relevant impacts on other approved regulators.

I. IMPLEMENTATION TIMETABLE

90. If approved, the changes will come into effect on 1 November 2015.

J. STAKEHOLDER ENGAGEMENT

Domestic requirements

91. The SRA carried out a full public consultation between 18 November 2014 and 28 January 2015 on these proposals. This consultation was published on our website and notification was sent to subscribers in the usual way.

92. A copy of the report on consultation responses and SRA conclusions is attached as **Annex 2**.

93. After the consultation period we discussed our approach to redrafting the accountant's report form and the draft guidance with an external reference group members of which included The Law Society, CLLS, the Sole Practitioners Group, ICAEW, ACCS and a number of both law and accountancy firms. We also engaged our small firms reference group

Overseas Rules

94. The SRA carried out a full public consultation between 30 September and 22 December 2014 on these proposals. This consultation was published on our website and notification was sent to subscribers in the usual way.

95. A copy of the report on consultation responses and SRA views on them is attached as **Annex 5**.

96. During the consultation period we also discussed the issues arising with interested firms and with the City of London Law Society.

ANNEXES

`Annex 1	The SRA Amendment to Regulatory Arrangements (Accountants' Reports and Overseas Rules) Rules 2015 which includes in the schedules tracked changes to the SRA Glossary, the SAR and Overseas Rules
Annex 2	Report on consultation responses and SRA conclusions –domestic provisions
Annex 3	Draft Accountant's Report (AR1) Form
Annex 4	Draft SRA Guidance to Reporting Accountants and firms on planning and completion of the annual Accountant's Reports under Rule 32 of the SRA Accounts Rules 2011
Annex 5:	Report on consultation responses and SRA conclusions

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Date: 24/07/2015

Annex 1

SRA Amendment to Regulatory Arrangements (Accountants' Reports and Overseas Rules) Rules 2015

Rules dated [xxxx] 2015 made by the Solicitors Regulation Authority Board

under Part I, Part II, sections 79 and 80 of the Solicitors Act 1974 and sections 9 and 9A of the Administration of Justice Act 1985 and section 89 of, and Schedule 14 to, the Courts and Legal Services Act 1990 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 instruments referred to in column 1 of the table set out in Schedule 1 shall be amended in accordance with the corresponding entry in column 2.

Rule 2

The SRA Accounts Rules 2011 shall be amended in accordance with Schedule 2 where underlining indicates new text to be inserted and striking through indicates deleted text.

Rule 3

The SRA Overseas Rules 2013 shall be amended in accordance with Schedule 3 where underlining indicates new text to be inserted and striking through indicates deleted text.

Rule 4

Any accountant's report that you would have been required to deliver under Rule 50.4 of the SRA Accounts Rules 2011 in respect of the accounting period up and including 31 October 2015 must still be delivered as if these amendments had not been made.

Rule 5
These amendment rules shall come into force on 1 November 2015.

Schedule 1 to the SRA Amendment to Regulatory Arrangements (Accountants' Reports and Overseas Rules) Rules 2015

(1) Instrument	(2) Provision
SRA Handbook Glossary 2012	Insert the following new definition: "**Office money (overseas)** means money which belongs to you or your ***overseas practice***. This includes money held or received in respect of: (a) The running of your ***overseas practice***, for example sales tax on your practice's ***fees***; (b) ***Fees*** due to you or your ***overseas practice*** against a bill or written notification of ***costs*** incurred which has been delivered to the ***client*** or paying party; and (c) ***disbursements*** already paid by you or your ***overseas practice***; (d) ***disbursements*** incurred but not yet paid by you or your ***overseas practice***, but excluding unpaid ***professional disbursements***. Delete the definition of **client account overseas** and replace with 'means an account at a bank or similar institution, subject to supervision by a public authority, which is used only for the purpose of holding ***client money (overseas)***, and the title, designation or account details allow the account to be identified as belonging to the client or clients of a ***solicitor*** or ***REL*** or that they are being held subject to a ***trust.'*** Delete the definition of **client money (overseas)** and replace with 'means money held or received for a ***client*** in respect of legal services that you are providing or as ***trustee***, and all other money which is not ***office money (overseas)***. This includes money held or received: (a) As ***trustee****;* (b) As agent, bailee, stakeholder, or as the donee of a power of attorney, or as a liquidator, trustee in bankruptcy, *Court of Protection deputy* or trustee of an occupational pension scheme; (c) For payment of unpaid ***professional disbursements***; (d) For payment of taxes, duties or fees on behalf of clients or third parties; (e) As a payment on account of ***costs*** and ***disbursements*** generally;

	(f) Jointly with another person outside of your practice; (g) To the sender's order.'

Schedule 2 to the SRA Amendment to Regulatory Arrangements (Accountants' Reports and Overseas Rules) Rules 2015

See Appendix to Annex 1

Schedule 3 to the SRA Amendment to Regulatory Arrangements (Accountants' Reports and Overseas Rules) Rules 2015

SRA Overseas Rules 2013

Rules dated 30 August 2013 made by the Solicitors Regulation Authority Board under sections 31, 32, 33A, 34, 79 and 80 of the Solicitors Act 1974, sections 9 and 9A of the Administration of Justice Act 1985 and section 83 of, and paragraph 20 of 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 regulating the conduct of solicitors and their employees, registered European lawyers and their employees, registered foreign lawyers, recognised bodies and their managers and employees and licensed bodies and their managers and employees.

Part 1: The Overseas Principles

Rule 1: Overseas Principles

1.1 You

(a) as a ***regulated individual practising overseas*** must ensure that you; or

(b) as a ***responsible authorised body*** must ensure that your ***overseas practice***, and individual ***managers***, and ***members*** and ***owners*** of your ***overseas practice*** (who are, for the purposes of these rules, 'those for whom you are responsible');

comply with the Overseas Principles stated below.

1.2 Each of the Overseas Principles stated below, is supplemented by a note to assist individuals and bodies to determine how best to comply with each Principle. These notes do not form part of the Principles and are for guidance only.

1.3 Overseas Principle 1: You must uphold the rule of the law and the proper administration of justice in England and Wales.

Guidance note

(i) Your obligations to ***clients***, the ***court*** and third parties in England and Wales with whom you are dealing on behalf of your ***clients*** are unaffected by the location outside England and Wales from which you practise or by the location of your ***overseas practice***.

1.4 Overseas Principle 2: You must act with integrity.

Guidance note

(i) Personal integrity is central to your role as the ***client's*** trusted adviser and should characterise all of your professional dealings with ***clients***, the ***court***, other ***lawyers*** and the public, wherever they are being conducted. You should use your judgment when considering how best to maintain your integrity at all times and avoid any behaviour outside England and Wales which undermines your character and suitability to be an ***authorised person***. A ***responsible authorised body*** should ensure that its ***overseas practices*** observe comparable standards.

1.5 Overseas Principle 3: You must not allow your independence or the independence of your ***overseas practice*** to be compromised.

Guidance note

(i) "Independence" means your own independence and that of your firm and your ***overseas practice***, and not merely your ability to give independent advice to a ***client***. You should avoid giving control of your ***overseas practice*** to a third party beyond any local legal or regulatory ownership requirements.

1.6 Overseas Principle 4: You must act in the best interests of each ***client***.

Guidance note

(i) You should act in good faith and do your best for each of the ***clients*** for whom you are (or your ***overseas practice*** is) acting. In particular, you should follow the local legal or regulatory requirements of the jurisdiction in which you or your ***overseas practice*** are practising in relation to confidentiality and conflicts of interest. If no such requirements exist, you should be guided by what you consider to be the best interests of each ***client*** in the circumstances.

1.7 Overseas Principle 5: You must provide a proper standard of service to your ***clients***/the ***clients*** of your ***overseas practice***.

Guidance note

(i) You should provide a proper standard of client care and work. This includes exercising competence, skill and diligence and taking into account the individual needs and circumstances of each ***client*** as well as the particular requirements and circumstances of the jurisdiction in which you are working. If your ***client*** meets the definition of a complainant under Section 128(3) of the Legal Services Act 2007 or the Legal Services Act 2007 (Legal Complaints) (Parties) Order 2010, you should inform the ***client*** who is regulating the legal services you or your ***overseas practice*** is providing to the ***client***, what client protections are in place and whether they have the benefit of professional indemnity insurance or other indemnity.

1.8 Overseas Principle 6: You must not do anything which will or will be likely to bring into disrepute the ***overseas practice***, yourself as a ***regulated individual*** or ***responsible authorised body*** or, by association, the legal profession in and of England and Wales.

Guidance note

(i) This includes any behaviour which occurs within or outside your professional ***practice*** which undermines your own reputation, that of the ***practice*** within which you are a ***manager*** or solicitor employee, or the wider reputation of the legal profession in and of England and Wales.

1.9 Overseas Principle 7: You must comply with your legal and regulatory obligations in England and Wales, and deal with your regulators and ombudsmen in England and Wales in an open, timely and co-operative manner and assist and not impede any ***authorised person*** or ***authorised body*** practising in England and Wales in complying with their legal and regulatory obligations and dealings with their regulators and ombudsmen.

Guidance note

(i) As a ***responsible authorised body***, you should ensure that you, and those for whom you are responsible, comply with all of the reporting and notification requirements that apply to you and respond promptly and substantively to communications. You should ensure that you (and those for whom you are responsible) do not cause, contribute or facilitate a failure to comply with the ***SRA's*** regulatory arrangements by any ***authorised person*** or ***authorised body*** practising in England and Wales. ***Regulated individuals practising overseas*** should assist their ***responsible authorised body*** to comply with its regulatory obligations to the ***SRA***.

1.10 Overseas Principle 8: You must run your business/the business of your ***overseas practice*** or carry out your/their role in the business effectively and in accordance with proper governance and sound financial and risk management principles.

Guidance note

(i) As a ***responsible authorised body*** you are required to ensure that your relations with your ***overseas practice*** accord with sound governance, financial and risk management principles. You should ensure that those for whom you are responsible under these rules assist you in meeting your obligations to the ***SRA*** in relation to managing any risks that your ***overseas practice*** might pose to your operations.

1.11 Overseas Principle 9: You must run your business/the business of your ***overseas practice*** or carry out your/their role in the business in a way that encourages equality of opportunity and respect for diversity.

Guidance note

(i) Every jurisdiction has its own legal, regulatory and cultural framework for equality and diversity. The ***SRA*** does not expect, or require, ***regulated individuals*** or bodies ***practising overseas*** to approach these issues as they would in England and Wales. It does, however, expect that ***SRA regulated individuals*** and bodies will do what they reasonably can to encourage equality of opportunity and respect for diversity, within the legal, regulatory and cultural context in which they are ***practising overseas***.

1.12 Overseas Principle 10: You must protect ***client ~~money~~*** **money** and assets.

Guidance note

(i) In addition to complying with the specific requirements in the following parts of these rules, ~~Y~~ *you and those for whom you are responsible should comply with local regulatory requirements in relation to* **client** ***~~money~~*** **money**, documents and assets and, in any event, you should ensure that they are protected appropriately.

Part 2: Application

Rule 2: Application

2.1 With regard to the Overseas Principles set out in Rule 1:

(a) they apply to you if you are a ***regulated individual practising overseas***, or a ***responsible authorised body*** in relation to each of its ***overseas practices***;

(b) you will be committing a breach if you permit another person to do anything on your behalf which, if done by you, would constitute a breach of these rules;

(c) you should ensure that you and those for whom you are responsible under these rules comply with all legal and regulatory obligations applicable in the

jurisdiction outside England and Wales in which you or they are practising. You, and those for whom you are responsible under these rules, should not cause, contribute to or facilitate a failure to comply with those legal or regulatory obligations by any other person or body subject to them;

(d) where there is a conflict between compliance with the Overseas Principles set out in Rule 1 and/or the Overseas Accounts Rules or the Reporting Requirements set out in the following rules ~~Rule 3~~ on the one hand, and any requirements placed upon you or those for whom you are responsible under these rules by local law or regulation on the other hand, the latter shall prevail, with the exception of Overseas Principle 6, which must be observed at all times;

(e) ***Reserved legal activities*** may only be conducted overseas from an ***authorised body***. However, ***regulated individuals*** may conduct ***reserved legal activities*** overseas in the following circumstances:

(i) on an occasional basis from an ***Overseas Practice*** for clients in England and Wales provided that they comply with the ***SRA Principles*** and the provisions in Chapter 13A.3 to 13A.6 of the ***SRA Code of Conduct*** when conducting those ***reserved legal activities***.

(ii) from an ***Overseas Practice*** under the Overseas Principles provided that this work is undertaken for clients based outside England and Wales.

(f) Notwithstanding (e) above, if you are a ***solicitor*** or a ***REL***, and your ***practice*** predominantly and consistently comprises the provision of legal services to clients, or in relation to assets located in England and Wales, then regardless of where you are ***established***, the ***SRA Principles*** and Chapter 13A of the ***SRA Code of Conduct*** will apply;

(g) if you are a ***regulated individual practising overseas***, or a ***responsible authorised body***, you must ensure that you, or those for whom you are responsible under these rules, comply with any requirements under:

(i) the SRA Property Selling Rules 2011;

(ii) the ***SRA Insolvency Practice Rules***;

(iii) the ***SRA European Cross-border Practice Rules***;

(iv) the ***SRA Financial Services (Scope) Rules***;

(v) the SRA Financial Services (Conduct of Business) Rules 2001; and

(vi) the SRA Quality Assurance Scheme for Advocates (Crime) Regulations [2013];

which apply to you or your ***overseas practice***.

Part 3: Overseas Accounts Rules

Rule 3: Purpose of the overseas accounts provisions

3.1 The purpose of Part 3 of these rules is to describe how Overseas Principle 10 applies to ***client money (overseas)*** in order to ensure that it is protected and used for appropriate and proper purposes only.

Rule 4: Application and waivers

4.1 You:

(a) As a ***regulated individual practising overseas*** must ensure that you; or

(b) As a **r*esponsible authorised body***, must ensure that your ***overseas practice***, and those for whom you are responsible,

comply both with Parts 3 and 4 of these rules, and any applicable legal or regulatory requirements of the jurisdiction in which you or your ***overseas practice*** are practising relating to handling of client money or assets. If compliance with any provision of these rules would result in you or your ***overseas practice*** breaching local law or regulation, you may disregard that provision to the extent necessary to comply with the local requirements subject to the overriding obligations of Overseas Principle 6

4.2 In any particular case or cases the ***SRA*** may waive in writing any of the provisions of Parts 3 or 4 of these Rules, may place conditions on, and may revoke any waiver.

Rule 5: Dealings with client money

5.1 In all dealings with ***client money (overseas)*,** you as a **r*esponsible authorised body*** must ensure that your ***overseas practice*** :

(a) keeps ***client money (overseas)***, separate from money which is not ***client money (overseas)*** ;

(b) on receipt, pays ***client money (overseas)*** into a ***client account (overseas*)** without undue delay and keeps it there, unless the ***client*** has agreed otherwise or it is paid directly to a third party in the execution of a ***trust*** under which it is held;

(c) ensures by use of proper accounting systems and processes that ***client money (overseas*)** is used for the relevant ***client's*** matters only and for the purposes for which they have been paid;

(d) uses money held as ***trustee*** of a ***trust*** for the purposes of that ***trust*** only;

(e) establishes and maintains proper accounting systems and proper internal controls over those systems to ensure compliance with these rules;

(f) returns ***client money (overseas)*** to the person on whose behalf the money is held promptly, as soon as there is no longer any proper reason to retain those funds;

(g) keeps accounting records to show accurately the position with regard to the money held for each ***client*** and ***trust*** for a minimum period of six years; and

(h) accounts for interest on ***client money (overseas)*** in accordance with local law and customs of the jurisdiction in which you or your ***overseas practice*** are practising and otherwise when it is fair and reasonable to do so in all circumstances.

Part ~~3~~4 Reporting requirements

Rule ~~3~~6 Reporting requirements

~~3~~6.1 The ***SRA*** does not expect or require the same level of detailed monitoring, reporting and notification from those ***practising overseas*** as it would expect of ***authorised persons*** and ***authorised bodies*** in England and Wales. The level of reporting the ***SRA*** expects is proportionate to the level of regulatory risk posed by an ***overseas practice***.

~~3~~6.2 You, as a ***regulated individual practising overseas*** or as a ***responsible authorised body***, must monitor any material or systemic breaches of the Overseas Principles that apply to you or to those for whom you are responsible and report them to the ***SRA*** when they occur, or as soon as reasonably practicable thereafter. In relation to an ***overseas practice***, a material or systemic breach will relate either to the character and suitability of an individual, the financial vulnerability of an ***overseas practice*** outside of established business planning, or a pattern of behaviour within an ***overseas practice*** that infringes Overseas Principle 6. Notifications by the compliance officer of a ***responsible authorised body***, or by another person on behalf of an ***overseas practice*** will satisfy these requirements without separate notifications from each individual or body who has knowledge of the breach. For example, you will be required to:

(a) notify the ***SRA***, if you, or any of the ***partners***, ***members***, ***managers***, solicitor employees or other professionally qualified employees in your ***overseas practice***, are convicted by any ***court*** of a criminal offence or become subject to disciplinary action by another regulator;

(b) notify the ***SRA*** immediately if you believe that your firm or your ***overseas practice*** is in serious financial difficulty;

(c) provide the ***SRA*** with documents held by you or your ***overseas practice***, to which it is entitled, and any necessary permissions to access information as soon as possible following a notice from the ***SRA*** to do so.

(d) provide the ***SRA***, if you are a ***responsible authorised body***, with an annual return which:

(i) identifies the contact details of the office(s) from which you are, or your ***overseas practice*** is, practising, and

(ii) confirms that you have fulfilled your reporting and notification obligations

6.3 The ***SRA*** may require the delivery of an accountant's report by you as a ***responsible authorised body*** in respect of your ***overseas practice(s)***.

6.4 This report must:

(a) be signed by a qualified accountant approved by the ***SRA***;
(b) contain the information specifically requested by the ***SRA*** in relation to the protection and movement of ***client money (overseas)***;
(c) contain a description of the reporting accountant's examination of your records and relevant documentation;
(d) contain a statement from the reporting accountant which confirms that, save for trivial breaches:
i. you have complied with Rule 5; or
ii. where you have breached the requirements of Rule 5 this is because you have been bound by local law or regulation to do so, giving details of all such breaches.

6.5 You as a ***regulated individual practising overseas*** or a ***responsible authorised body*** must promptly comply with a written notice from the ***SRA*** that you must produce for inspection by the appointee of the ***SRA*** all documents held by you or held under your control and all information and explanations requested

~~Part 4: Commencement~~

~~Rule 4: Commencement~~

~~4.1 These Rules shall come into force as follows:~~

~~(a) Rule 1, 2 and 4 of these rules shall come into force on 1 October 2013, for:~~

~~(i) ***regulated individuals*** falling within the definition of ***practising overseas***, and~~

~~(ii) persons falling within paragraph (i)(a) and (e) of the definition of ***overseas practice***,~~

~~(b) Otherwise, these rules shall come into force on 1 October 2014.~~

Annex 2 Report on consultation responses and SRA conclusions –domestic provisions

Proportionate regulation: changes to reporting accountant requirements

Summary of responses

Introduction

1 On 18 November 2014 we issued a consultation document seeking views on proposals to change the requirement to deliver annual accountant's reports set out in the SRA Accounts Rules 2011 ("the Accounts Rules"). 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 28 January 2015. This report summarises the key points emerging from the responses.

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.

Appendix 1 - The responses

Question 1: Do you agree with the proposal that we should rely more on the professional judgement of the accountant completing the report? Do you see any specific issues or concerns with this approach?

4 Most respondents were in agreement with the proposal, although a number did suggest the need for further guidance from the SRA on matters that should be covered in the report. Furthermore, a number of respondents were in agreement that the current system of reporting is not fit for purpose.

5 One respondent recognised that without a detailed framework, which describes the characteristics that the SRA would expect a law firm's client money accounting system to have, the proposals will likely result in inconsistency of approach.

6 The Law Society suggested that 'there should be more scope for an accountant to use their professional judgement about the adequacy of the firms systems and controls. In particular, the exercise of greater professional judgement in qualifying reports will help to ensure that only when client money is at risk and/or there are serious breaches are reports qualified.'

7 One respondent firm of accountants highlighted a potential advantage of the proposed reporting form, noting that 'the Reporting Accountant will be required to engage with firms in relation to the effectiveness of their systems and the control environment which should then lead to firms focusing on how to improve these, rather than simply looking to 'avoid' rule breaches under the current reporting regime.

8 The Solicitors Disciplinary Tribunal (SDT) stated that many cases brought before the Tribunal relate to the mishandling of client money and felt that a move in emphasis towards reliance on an accountant's professional judgement could have a risk of

encouraging more complex and disputed disciplinary proceedings, due to a possible temptation for solicitors to blame their accountants for their own shortcomings in the event of enforcement action by the SRA.

SRA Reply

9 We will implement the proposals, noting the general support for the direction of travel. It is important to clarify that these proposals do not change the requirements in the Accounts Rules 2011 ("the Accounts Rules") that firms have to follow or the systems that they have to maintain to ensure compliance. The responsibility to comply with the Accounts Rules remains on the firm, not on the Reporting Accountant, and we do not therefore believe that any risk that disciplinary proceedings will become more difficult or complex in relation to breaches of those rules will materialise. Further, and for the avoidance of doubt, the guidance that we have issued confirms that one of the circumstances which will lead the reporting acountant to qualify the report is where there has been a significant failure by the solicitor to provide requested documentation. .

10 Under the Accounts Rules, the reporting accountant has to be a member of one of five professional bodies and must also be a registered auditor (or a manager or employee of one).[8] They will have professional obligations (for example to make proper examination of records). Allowing accountants to adopt testing processes that are appropriate to the particular firm and focusing the qualified reports on material breaches is likely to provide reports that are of more benefit to the firm and, if disciplinary proceedings are necessary, to the SRA and the SDT.

11 We accepted the need to provide more guidance to firms and accountants in relation to the reports and testing procedures – this issue is covered below.

Question 2: Do you agree with the revised criteria for qualification as reflected in amendments to the format of the accountant's report located at Annex 1?

12 Respondents were broadly in agreement with the proposal whilst again noting the need for clear guidance, with a number of respondents in particular seeking clarity on what might be considered 'substantive' in relation to compliance with the rules.

13 The Law Society stated: 'We agree with the proposal but in order for it to be effective accountants will need some guidance on what might be considered a serious deficiency in each area to ensure consistency in qualification and reporting. Lack of guidance for COLPs and COFAs on reporting material breaches has led to considerable confusion and a variation in reporting practices. We would not want to see this repeated for reporting accountants'.

14 One respondent highlighted a benefit in targeted criteria, responding that '[the revised criteria] remove considerable information which previously appeared to have limited value and took time to collate and created unnecessary costs.'

15 The Solicitors Disciplinary Tribunal noted that there should be 'clear and unequivocal guidance to the accountant as to the SRA's expectations to ensure compliance with the relevant regulatory objectives'.

16 A minority of respondents were not in favour of guidance from the SRA, with the City of London Law Society noting that 'any such guidance would naturally acquire

[8] See Account Rule 34.1

considerable authority and may come to confine the accountants' discretion', preferring that any such guidance 'should be developed by the accountancy professional bodies for their members'.

SRA Reply

17 In responses to this question and to questions 1 and 6 a significant number of respondents highlighted the need for further guidance. We took the view that it was important to develop this guidance collaboratively and to take on board the input of both legal practitioners and of accountants and their representatives.

18 The revised accountant's reports form and new draft guidance were discussed with that group, and have been amended where appropriate to reflect comments made at the discussion and subsequently by e-mail[9]. We also circulated the documents to our small practices and sole practitioner's virtual reference groups for further comments.[10]The guidance is intended for both firms and accountants and subject to any comments from Board members will be published online following this meeting.

19 In response to points made by respondents, the guidance specifically sets out the new approach. In our view, the report should only be qualified where the breaches identified are material and are therefore likely to put client money at risk. It clarifies that, whilst we recognise that trivial breaches of the Accounts Rules do occur in many firms, we are not expecting all identified breaches to be notified to us in the form of a qualified report. It goes on to provide assistance to accountants in deciding when breaches are material and when reports should be qualified; setting out (in section 2 of the guidance) some indicative factors indicating a significant weakness in the firm's systems and controls, such as a significant and/or unreplaced shortfall on client account. Further, it includes a table setting out particular checks and controls that the accountant might wish to perform if appropriate for the firm (section 3), highlighting 'best practice', 'adequate practice' and 'below adequate practice'. 'Below adequate practice' could lead to qualification, depending whether there is a risk to client money. The 'best practice' element of the guidance – which was welcomed by members of the working group - is there to assist firms in benchmarking their accounting processes and making improvements should they wish to do so.

Question 3: Do you have any specific comments on the proposed revisions to the format of the accountant's report in particular do you think: a) that the wording covers the main areas accountants should be reporting on? b) that the level of detail we suggest is given by the accountant in the report if deficiencies are found is right?

20 One respondent highlighted that the SRA is 'obviously looking towards a risk-based approach towards the issue and it follows that the wording needs to cover this more modern and useful approach'.

21 Broadly the comments on the specific formatting of the accountant's report came from the accountancy firms, the majority of whom were in favour of the changes, noting they were 'supportive of a slimmed down version of the report' and 'we do believe that the wording covers the main areas that accountants should be reporting on'.

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[9] The Law Society also submitted some further comments from Committee members and practitioners.

[10] These were set up as part of our package of small firms initiatives – see http://www.sra.org.uk/smallfirms/

22 The ICAEW suggested that 'the space provided on [the report] for any matters in relation to deficiencies in the firm's systems of where the accountant has not been able to satisfy him/herself may not be sufficient for the level of detail that is needed here.

23 A number of respondents, including one firm of accountants offered more detailed comments and assistance in finalising the AR1 form and associated guidance for accountants.

SRA Reply

24 We have produced a revised report form, taking into account the comments of respondents and the further process of development via the working group set out above.

Question 4: Do you think that the revised approach will have an impact on fees charged by accountants to do the work?

25 A number of respondents felt that the revised approach would lead to an increase in fees, with one respondent noting that 'reporting accountants will be inclined to perform more work rather than less, resulting in an increase in fees for law firms'.

26 The Law Society said that the impact of the changes needed to be assessed. They stated 'If the SRA confirms that the current system for undertaking an accountants' review will be acceptable in future the impact on fees for many firms will be limited, as many will chose in the short term to continue with the same tests. However, there will be flexibility for firms who wish to do so to have more tailored reports prepared. It is likely that these reports will be more expensive, as they will be individualised audits. If, however, the SRA does not deem that the existing procedures are acceptable under the new scheme and there is a need for new sets of procedures to be designed for these types of reviews there will inevitably be an additional cost.'

27 The ICAEW, amongst others, felt that with the SRA's stated intention to reform the Accounts Rules in 2016, that there would be extra costs for accountants and firms coming to terms with a new system that would then be subject to more radical change a further 6-12 months later. They recognised that 'the cost of work could rise again as the accountant revises or devises new work programmes to address [these] changes'.

28 A number of respondent accountancy firms felt that costs to Reporting Accountants would increase due to the transition to the proposed reporting requirements and suggested that these would be recovered from increased fees. Additionally, they suggest that if the revised work programme of reporting resulted in increased time costs, that their on-going fees would also increase.

29 The Liverpool Law Society felt that 'the additional time spent and increased risk [for the accountant] will be passed on in the fee charged to the firm'.

30 The City of London Law Society on the other hand stated that 'Whilst this approach is likely to remove some unnecessary activities which are currently driven by the checklist, this will be counterbalanced by some additional work in assessing the risks presented by the client firm, and in planning the audit programme to effectively address the client's risk profile. On balance, we do not believe that the revised approach should have any material impact on fees charged, but the investment should produce a better report which is more relevant to the firm.'

31 Other respondents concurred that the impact on costs would be neutral, or felt that there would be a decrease in costs. One firm of chartered accountants stated “Under the old 'tick and bash' approach one used relatively inexperienced staff, properly supervised, whose work could be reviewed by someone more senior. By moving to a risk-based approach, more senior people will need to be involved in the work, as only they will have the experience to identify when there could be a problem. These factors will tend to balance each other out, so overall I don't predict a huge change in cost”.

32 The Sole Practitioners Group stated that “one would hope that less detail than potentially unnecessary checking should give rise to a lower level of fees. No doubt accountants will be guided significantly by the level of expertise of those involved in preparing the books of account and if previous experience shows few deficiencies if any then of the time spent on a subsequent report may be significantly reduced.”

SRA Reply

33 We have carefully considered the issues of potential cost of implementation raised by the respondents.

34 There are no changes to the Accounts Rules in relation to how firms should treat client money. This means that firms do not have to design new internal accounting procedures to accommodate the reforms.

35 Instead the new approach is intended to achieve two results. Firstly, as set out above, it means that reporting accountants will not feel obliged to qualify reports for non-material breaches to the Accounts Rules that do not put client money at risk.

36 Secondly it provides discretion to reporting accountants as to how to assess whether the Accounts Rules are complied with. We are no longer prescriptive in terms of how the accountant must assess that compliance. The guidance contains advice on how they might wish to do so in discussion with firms and in accordance with their professional judgment bearing in mind the firm’s size and complexity, areas of work, systems and controls and compliance history. If firms wish to agree with their accountants to continue using the current prescriptive sampling method as a way of carrying out that assessment they are free to do so provided that this gives them the information needed to properly complete the form we require. Further, if firms have already commenced work with their accountant for the next accounting deadline, they are not obliged to change the procedures.

37 This means that any upward impact on accountant’s fees as a result of these reforms will be limited.

38 Given this position, we consider that it is appropriate to make these changes now before wholesale change of the Accounts Rules themselves. The SRA’s reform programme in this area, as in others, involves a number of stages. There are no doubt many issues that will arise in preparation and consultation on a set of new Accounts Rules and any implementation should allow adequate time for these issues to be resolved. What is important is that the changes implemented now in stage 2 are consistent with the general approach that will be taken later.

39 Focusing the accountants report on the safety of client money rather than on checklists or minor breaches of technical requirements is an approach that will match our intentions in relation to the Accounts Rules as a whole.

Question 5: Do you consider that the revised approach will have any impact on attitudes to compliance by COFAs/the firms?

40 Many respondents recognised that the revised approach put a greater emphasis on systems and processes for the firms, with one large firm of accountants noting that the 'revised framework will encourage COFAs and firms to improve their systems and implement suggestions made by their advisers'. The Association of Chartered Certified Accountants (ACCA) agreed and noted that 'any impact is likely to be positive' and 'this should encourage greater engagement with the accounting requirements by both COFAs and firms'.

41 A significant minority were concerned that 'individuals responsible for client money may view the proposals as a relaxation of the Rules and this in turn could result in a more lax attitude towards them'

SRA reply

42 These changes should encourage COFAs and firms to take a more purposive approach – our publication of best practice advice in the guidance will help firms to increase standards. Although the new guidance confirms that generally, accounts do not need to be qualified for non material breaches, this does not reflect a relaxation of the rules themselves but is a statement of the position that the SRA takes in relation to breaches of rules generally; see also guidance note (x) to Rule 8 of the SRA Authorisation Rules 2011.

Question 6: Do you think that the proposed changes should be supported by separate guidance to aid the accountants in the work they should be undertaking?

43 Respondents strongly endorsed the need for guidance and a framework to provide accountants with the tools they need to do their work objectively, with the ICAEW noting that 'in the absence of any guidance from the SRA there will be an expectation gap and too much room for interpretation which could result in inconsistencies in the level of work performed and hence assurance provided.'

44 The Law Society stated that 'it is essential that guidance that sets out the removal of prescription does not negate the need for accountants to undertake all necessary tests to ensure themselves of the firm's compliance with SRA requirements."

45 A number of respondents, including one firm of accountants, offered to assist the SRA in producing guidance to aid accountants in meeting the new requirements.

SRA reply

46 We have developed further guidance in discussion with stakeholders as set out above.

Question 7: Do you consider that it would be helpful to require a declaration of compliance by the firm with their obligation to obtain/deliver a report in accordance with the Accounts Rules as some stakeholders have suggested to us? If you do it would be helpful if you could explain why.

47 One respondent noted the comments provided by the SRA in the consultation and re-highlighted that 'if a law firm was in a position of not complying they may well also be satisfied to falsely declare... on balance we tend to agree that a separate annual

declaration by a firm that it has complied with the SRA Accounts Rules has limited value.'

48 Many other respondents concurred with the view of the SRA, that it was unnecessary to ask firms to sign a specific declaration of compliance with the Accounts Rules.

49 Those respondents that favoured a declaration felt that it would focus the mind of the firm on compliance.

SRA reply

50 Our view remains that it is inappropriate to 'regulate by declaration' and that firms should comply with all the rules in the Handbook. We consider that asking firms to sign a declaration of compliance as part of the annual bulk renewal process will not add value in real terms and we concur with those respondents who felt that we should not introduce this change.

Question 8: Do you think that the existing obligations on reporting accountants to notify us immediately of significant concerns during the course of preparation of their reports should be tightened or enhanced in any way?

51 Respondents overwhelmingly felt that the current obligations were sufficient and acceptable, including one respondent firm which noted that 'Reporting Accountants are already obliged to report on fraud and concerns over the firm's ability to meeting its commitments to clients and the SRA'.

52 The Sole Practitioners Group noted 'there is a rigorous requirement of accountants to report fraud, dishonesty or improper use of a client account and there is no particular reason why that should change or require to be tightened up.

53 The Law Society stated 'There is the potential for a firm with a qualified report not to submit it to the SRA. While we do not believe the duty needs to be enhanced, it is therefore important that all accountants are reminded of their duty to report to the SRA if client money is at risk.'

SRA reply

54 We agree that the existing reporting obligations are generally adequate. However, we have added a requirement in the standard terms of engagement in Account Rule 35.1 for the accountant to notify us immediately if they discover that a previously qualified report has not been filed. The guidance for reporting accountants also contains a reminder of their duties to immediately report to us any evidence of theft or fraud or significant concerns about the fitness and propriety of the firm to hold client money. The Rules also impose a requirement on the firm and the accountant to retain a copy of the report for at least 6 years (increased from 3 years in the current rules).

Question 9: Do you think we should be exploring the option to require reporting accountants to deliver reports to us as opposed to leaving the obligation on the firms?

55 Although the majority of respondents felt strongly that the obligation should remain with the solicitor firms, there were a small minority of responses from the accountancy sector who felt that the option should be explored.

56 One respondent firm highlighted that 'as the regulated firm, with the responsibility for compliance to its regulatory body, we feel the obligation to submit reports must remain with us... rather than a third party.' The SDT also noted that [requiring reporting accountants to deliver reports directly to the SRA] may also further increase accountants' fees in response to what they will probably perceive as an extra layer of responsibility placed on their shoulders'.

57 A respondent accountants firm recognised that there 'is a potentially greater risk of differences of opinion between firms and the Reporting Accountants [as a result of the proposals for change]. It is important that the Reporting Accountant is able to report their findings and opinions to the SRA in these situations as they will typically represent higher risk instances'.

58 The Law Society felt that the obligation should remain on the solicitor's firm but did suggest that 'the new simplified report could be submitted electronically to limit the work for the SRA'.

SRA reply

59 We will retain the current position. The responsibility to comply with the rules lies with the firm, and those respondents that represented solicitors were particularly clear that we should not change the current requirement. We will look into options for electronic filing in line with the further development of the SRA's systems.

Question 10: Do you agree with the proposal to introduce risk-based criteria that will exempt firms with a certain profile from the requirement to obtain and deliver an accountant's report?

60 A significant number of respondents felt that this approach would have merit if based on the SRAs experience of risk and loss to clients, with the ICAEW noting ' we would be supportive of proposals to introduce risk-based criteria that might exempt certain firms from the requirement... where empirical evidence supports their low risk and where mechanisms were in place to ensure that the criteria were being adhered to.'

61 ACCA stated 'Subject to appropriate criteria being identified, ACCA supports this proposal, as it represents a further move towards proportionate regulation.'

62 The Law Society said: 'We agree that there may be some firms who could be exempted from the requirements on a risk basis. However, the SRA has provided no evidence that the categories of firms it has selected are less risky than those who are required to submit a report.'

63 Some other respondents opposed the idea taking the view that any risk to client money was unacceptable.

SRA reply

64 No system can provide a guarantee of 100% client protection – and indeed to do so would disproportionately increase the costs of regulation and therefore act as a barrier to firms entering the market and/or increase costs to consumers. The aim must be to ensure any safeguards or requirements are appropriately targeted at areas of highest risk, both in terms of the likelihood of that risk materialising and the nature of any harm that might result. The maximum client account levels we have proposed will limit the degree of harm that can arise in exempted firms (see our reply to Question 11 below).

Further, we note that other consumer protections exist (such as compulsory professional indemnity insurance and the compensation fund, should risks materialise). Therefore, as a matter of general approach, we do consider it appropriate to continue to impose a blanket requirement to obtain a report from all firms, particularly given that this is not the only, way for serious concerns about risks to client money to be brought to our attention.

Question 11: Do you agree that our proposed criteria capture a lower level of risk to client monies? Are there any concerns that these criteria pose an unacceptable level of risk to client monies? Or do you think we have missed other criteria?

65 Although several respondents gave a cautious response, seeking further evidence of the risk profiles of the firms that would not be required to submit a report, there was significant support for the suggested approach of providing additional categories of lower risk firms that would not have to submit accounting reports.

66 A number of respondents (including ACCA) agreed that the average aggregate balance on a client account. Other respondents pointed out the need to look at maximum balances and/or a power to require reports from exempted firms in exceptional circumstances. For example, ICAEW stated

"The criteria suggested could also mask large sums of client monies held for small periods so it might be preferable to have an additional one off limit at any point in time".

67 Others such as the Sole Practitioners Group felt that we should consider not exempting firms that carry out certain activities e.g. estate administration work or conveyancing. A number of respondents stated that we should define the aggregate limit carefully to avoid possible manipulation of the rule, for example by specifying that average should be set as the 'mean' and including all separate client accounts held by the firm. There were also suggestions (for example from a large firm of accountants) that the number and value of transactions should be considered.

68 The Manchester Law Society suggested that the SRA analyse the compensation fund payments to assist in determining the criteria for capturing a lower level of risk and that in the interim the SRA may also wish to review the average balance criteria for waivers (currently set at £10,000).

69 One respondent suggested that, as an alternative to removing the requirement for low risk firms, that instead these firms could be required 'to deliver an Accountant's Report on a rotation basis, perhaps every two to three years'.

70 Those respondents that had opposed the exemption of any firms from the requirement tended to repeat their opposition in response to this question.

SRA reply

71 `In the consultation paper we stated that 'our current thinking that the appropriate criterion is to exclude the firms which hold an average balance of client funds of less than £10,000 in each accounting year'.

72 We consider that the £10,000 limit consulted upon remains an appropriate test, subject to the suggested addition below and based on the risk assessment set out in the succeeding paragraphs. We have used client money information supplied by firms as part of the annual bulk practising certificate renewal exercise (PCRE) which includes

average, maximum and minimum balances. These values are based on reconciliations that are in effect snapshots which in accordance with the Accounts Rules must occur at least once every five weeks but can occur much more often. The frequency of the reconciliations will affect the average produced. Our analysis of client money data has shown us that the proposed category of firms that have a £10,000 or less average client account balance over the year includes some firms that hold very significant maximum amounts of client money, potentially on a one-off basis. This includes firms who have a maximum client money balance of many multiples of the average - including some firms with a maximum over £1 million.

73 We therefore consider that as well as imposing a maximum average client balance we should use an additional criterion. Although we do not hold data on the number or type of transactions that firms carry out, we do hold data on their maximum client balance. We believe that this is a reasonable measure as it links clearly to the impact of any failures. We therefore decided that in order to be exempt, firms should have had a maximum client balance of no more than £250,000 at any reconciliation point during the accounting year. This would require any firm that carries out anything more than a negligible amount of conveyancing or estate administration activity to continue to obtain an accountant's report, such that there is no need to formally exclude those activities from any exemption.

74 Applying both of these criteria (average client account balance of no more than £10,000 and a maximum balance of no more than £250,000) would exempt 1014 firms from the need to file an accountants report based on data we collected as part of the November 2014 PCRE . This is around 13% of firms who reported holding client money. We will refer to these firms as the 'exempted firms'.

75 We made a number of comparisons of the relevant risks posed by the exempted firms compared to 'all firms' - the general population of firms that hold client money[11].

76 Details of these comparisons are set out in our Impact assessment. Our conclusion overall is that exempted firms are significantly lower risk in areas relating to client money and accountant's reports than the general population of firms that hold client money. This does not mean that as a category these firms are entirely risk free –but we are satisfied that the risk is at a tolerable level and that given that other consumer protections such as compulsory professional indemnity insurance exist it is not appropriate to continue to impose a blanket requirement to obtain a report.

77 We recognise that some firms within the exempted firms' category may present particular risks. The draft amendment Rules retain the right for the SRA to require individual firms within the exempted category to obtain and/or submit accountants reports. Reported matters and other intelligence will lead us to investigate individual firms where needed and to impose immediate conditions requiring them to obtain reports on an annual or more frequent basis if the risk posed require such action[12].Some practitioners are already subject to special accounting report requirements by virtue of such conditions on their practicing certificate and these requirements will remain in place even if the firm within which they work would otherwise be within the exempted category.

78 The exclusion will of course only apply to firms in respect of an accounting period in which they meet the criteria. If in any subsequent period the amount of client money

[11] Firms that do not hold client money were excluded from the analysis.
[12] See Rule 32.2

held will exceed either of the limits then the firm will be required to obtain a report for that period.

79 We considered whether it was appropriate to specifically exclude any new firms from the exempted category – so that, for example, we would continue to require all firms to obtain an accountant's report in their first two years of operation. However, we decided not to recommend such action. Many new firms will be managed by solicitors with good records whom we already regulate and such firms will not be inherently risky. Any particular concerns raised by an individual application for authorisation can be dealt with by our Authorisation Directorate who will retain a power to impose a requirement to obtain and/or submit a report when considering applications.

80 We have retained the requirement that all firms (including those that will be otherwise exempted) which close down or otherwise cease to hold client money should obtain a 'ceasing to hold accountant's report' to ensure that they have properly accounted for all client money.

81 We do not hold the data to specifically assess whether firms that only hold client money on account of costs and disbursements presented lower risks as a group. However we consider that the great majority of these firms will be included in the proposed exclusion category in any event.

82 The amendment Rules therefore exempt firms from the requirement to obtain an accountants report if during the relevant accounting year they have had an average client account balance of £10,000 or less, and a maximum client account balance of £250,000 or less. (Firms are already used to collating this data for PCRE so the burden of doing so for these purposes should be lessened). As suggested by respondents we define the average balance figure by reference to the mean and we confirm that the total maximum balance is based on the total of all client accounts held, including for example all separate designated deposit accounts as well as general client account.

Question 12: Do you have any suggestions for themes or specific areas or issues we should consider in our forthcoming review of the Accounts Rules as a whole?

83 A number of respondents provided helpful themes and specific suggestions of issues that should be considered in the forthcoming review, in particular there was a general consensus that a more principle-based approach and a reduction in complexity would be welcomed. One respondent stated 'The accounts rules have been in place for a very long time and are long overdue a review so it is encouraging that this consultation is taking place in stages. ….The rules based approach should be more in line with OFR.'

84 Specific suggestions included:

- looking at the simplified approach to the Accounts Rules proposed for overseas firms as a precedent;
- modernising the rules to reflect the realities of internet banking;
- removing the prescriptive timetable in Rule 17 on transferring costs to office account;
- dealing with changed VAT and third party funds issues.

Other comments from the respondents

85 Alongside responses to the consultation questions, a small number of respondents provided additional commentary on the proposals. The City of London Law Society restated concerns over whether it 'is proportionate or necessary to tackle [the issues of this consultation] now and separate from the wider review [phase 3], and whether the benefits accruing from doing so adequately compensate for the disruption and risks it entails for both form and the accountancy profession.'

Appendix 2 - Respondents to the Consultation

Type of respondent	**Responses**
Law firms / solicitors	14
Accountancy firms	16
Representative groups, trade and membership associations	7
Local law societies	4
Other	1
TOTAL	42

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

Law firms and solicitors in private practice

A L Hughes & Co
Carol Ann Gregorious
DJM Solicitors
Gordons LLP
Janes Solicitors
John Cooke
Lane & Co Solicitors
Mayfield Bell
Reeves & Co LLP
Rix & Kay Solicitors LLP
WH Law LLP

Accountancy firms

Armstrong Watson
Baker Tilly
Crow Clark Whitehill LLP
D A Locke & Co

Deloitte
Francis Clark LLP
Grant Thornton UK LLP
Harwood Hutton
Hazlewoods LLP
Martin Briggs & Co
Mazars
Menzies LLP
MHA Accountancy Network
PwC UK
Ryecroft Glenton
Wilkins Kennedy LLP

Representative groups, trade and membership bodies, professional bodies

Association of Accounting Technicians
Association of Chartered Certified Accountants
Institute of Chartered Accountants in England Wales
Institute of Legal Finance & Management
Junior Lawyers Division's of The Law Society
The Law Society
The Sole Practitioners Group

Local Law Societies

City of London Law Society
City of Westminster and Holborn Law Society
Liverpool Law Society
Manchester Law Society

Other

Solicitors Disciplinary Tribunal

Annex 3

AR1

Accountant's Report Form (Draft)

The circumstances in which an annual Accountant's Report is required to be obtained and delivered to us are set out in rule 32 of the SRA Accounts Rules 2011 (the Rules). For further information on the Rules and for clarification on whether or not the requirement to deliver an Accountant's Report applies to you, see our website at http://www.sra.org.uk/solicitors/handbook/accountsrules/content.page.

This Report must be completed by the Accountant within 6 months of the end of the Accounting Period to which the Report relates.

The Accountant who prepares the Report must be qualified under rule 34 of the Rules.

The Accountant should have read carefully the separate Guidance [insert link] we have issued before commencing the programme of work which will enable completion of this Report. The Guidance provides useful information as to which Rules are covered by this Report, the areas and types of work they should be considering and the factors that might lead to qualification of this report.

When a practice closes but the ceased practice continues to hold or receive client money during the process of dealing with outstanding costs and unattributable or unreturnable funds, the Rules, including the obligation to deliver accountant's reports, will continue to apply.

When a practice ceases to hold and/or receive client money (and/or to operate any client's own account as signatory), either on closure of the practice or for any other reason, the practice must obtain and deliver a final report within six months of ceasing to hold and/or receive client money (and/or to operate any client's own account as signatory), whether qualified or not, unless we require earlier delivery.

If you need any assistance completing this Report please telephone the Contact Centre on 0370 606 2555. Our lines are open from 08.00 to 18.00 Monday, Wednesday, Thursday, Friday and 09.30 to 18.00 Tuesday. Please note calls may be monitored/recorded for training purposes.

If you are calling from overseas please use +44 (0) 121 329 6800. Note that reports in respect of practice from an office outside England and Wales are submitted under Part 7 of the Rules. Specimen form **AR2** may be used for such reports.

Section one: Firm details

Insert here all names used by the firm or in-house practice from the offices covered by this Report. This must include the registered name of a recognised body/licensed body which is an LLP or company, and the name under which a partnership or sole practitioner is recognised. It is assumed that all addresses used by the practice during the accounting period are covered by this report , except offices outside England and Wales (Refer to Part 7 of the Rules). All address(es) of the practice during the reporting period must be covered by an accountant's report.

Firm name(s) during the reporting period		Firm SRA no	

Report Period From		to	

Firm COFA(s) (if more than one) during the reporting period with dates of appointment		COFA's SRA no	
Dates of appointment (where appropriate)		to	

Is this a cease to hold Report? If yes this report should be submitted to the SRA by the firm whether qualified or not	Yes	No

Have any consultants or employees held or received client money, or operated a client's own account as signatory, during the report period	Yes	No

If **'yes'** please set out the details on a separate sheet of paper if necessary

Section two: Work undertaken and declarations

1. We confirm that we are qualified to prepare this Report in accordance with Rule 34 of the SRA Accounts Rules 2011

2. We confirm that a copy of this Report has been sent to the firm's current COFA as set out in Section 1 of this Report.

3. We confirm that we have carried out work to assess whether the firm has complied with the relevant Accounts Rules, in the period covered by this Report, namely – Rules 1, 7, 13, 14, 17, 18, 20, 21, 27 and 29 and also Rules 8, 9, 10, 15, 16 and 19 where applicable.

We have considered the SRA's guidance and have found material breaches of the Accounts Rules (as set out in 3 above), and/or significant weaknesses in the firm's systems and controls for compliance with the Accounts Rules (as set out in 3 above). We therefore consider that the SRA should be notified by our qualifying this Report." If yes then this Report should be submitted to the SRA and all matters of significance should be detailed in the box below (use continuation sheet if necessary).	Yes ☐	No ☐

Section 3: Accountant's details and signature

Name of accountant		Professional body	
		Accountant membership/ registration number	
Recognised Supervisory Body under which individual/firm is a registered auditor		Reference number of individual/firm audit registration(s)	
Firm name			
Firm address			
Email address			

Date of completion of this Report	
Signature of Accountant	
Name (Block Capitals)	

Once completed this Report should be returned by the firm within the time period required by the Rules via one of the options below:

Email: SRAAccountantsReports@sra.org.uk

Post: Authorisation – Accountant's Reports
Solicitors Regulation Authority
The Cube
199 Wharfside Street
Birmingham
B1 1RN

DX: DX 720293 Birmingham 47

These reports should be retained by both the firm and by the Reporting Accountant for at least six years, regardless of whether submitted to the SRA.

Annex 4

Draft/SRA's Guidance to Reporting Accountants and firms on planning and completion of the annual Accountant's Reports, under Rule 32 of the SRA Accounts Rules 2011

INTRODUCTION

We require firms to obtain an independent Accountant's Report to confirm that the overarching objective in Rule 1.1 of the SRA Accounts Rules 2011 (the Account Rules) is met – namely that client money is kept safe. Rule 1.2 sets out in more detail the principles that firms must meet to fulfil this overarching objective, including the delivery of annual Accountant's Reports.

We have modified our approach to the provision of Accountant's Reports to rely more on the Reporting Accountants' professional judgement when preparing and finalising the Report and to require only qualified Reports to be submitted to us. This guidance is intended to assist both the Accountants and the firm's COFA and managers in completing the Report, the current form of which can be found on our website here [insert link].

If during an accounting period, firms have met certain criteria around i) the small amounts of client money held (an average of less than or equal to £10,000 as well as a maximum of less than or equal to £250,000) or ii) the holding or receipt of money only from the Legal Aid Agency, they may be exempted from the requirement to obtain an Accountant's Report; for further detail see [insert link to Rule 32].

Rule 39 of the Accounts Rules, which required Accountants to undertake a lengthy standard number of detailed checks and tests when examining a firm's accounting records, has now been removed. Instead, Rule 38 requires the Accountants to use their professional judgement in adopting a suitable work programme and in deciding whether their subsequent Report needs to be qualified.

In our view, the Report should only be qualified where the breaches identified are material and likely to put client money at risk. (See section 2 and 3 below for examples.) When considering whether a breach is material, the Reporting Accountant should have regard to Rule 8 and associated guidance of the SRA Authorisation Rules for Legal Services Bodies and Licensable Bodies 2011 (the Authorisation Rules). Material breaches are likely to arise as a result of an intention to break the rules and/or as a result of a significant weakness in the firm's systems and controls such that there has been a systematic break down of controls designed to prevent breaches. Breaches arising from administrative error are less likely to be material, but still could be if they are persistent, derive from a lack of controls or break down of controls, and have put client money at risk. We recognise that trivial, non-material breaches of the Rules do occur in many firms and we are **not** expecting all identified breaches to be notified to us in the form of a qualified Report.

In all cases, the Accountant should ensure the work they undertake is proportionate and targeted to the size of firm and nature of the work the firm undertakes.

We accept that in light of the current prescriptive nature of the Accounts Rules, both the Accountants and the firms which instruct them may need some assistance and guidance at this time in:-

- planning what work might need to be undertaken and how to assure that client money is properly safeguarded ; and
- assessing what factors might lead to the Accountant to decide that the Report should be qualified and therefore submitted by the firm to us for further consideration of the risks posed.

We will keep this guidance under review and update it, as necessary.
Please note that we have also issued separate guidance on accounting procedures and systems that Reporting Accountants and firms will wish to have regard to – see SRA Guidelines – Accounting procedures and Systems [insert link].

We appreciate that some firms may wish to ask their Reporting Accountants to undertake additional work around the firm's systems and controls to aid the development of best practice, around compliance issues such as the effective operation of office account, the firm's compliance with the "client due diligence" requirements of the Money Laundering Regulations and cyber security. Ultimately this will be a matter for the firm to consider what it may need. This Guidance is therefore only designed to set out the areas of work that a Reporting Accountant may wish to consider to enable the completion of the Accountant's Report and the reporting of appropriate concerns to us. Our aim is to ensure that both we and the firms we regulate have an appropriate level of assurance that there are adequate controls over client money while not inflating inappropriately the cost to firms, and ultimately to consumers, by any unnecessary mandatory procedures.

The contents of this Guidance are not mandatory although we would expect both firms and the Accountant to have read it carefully prior to commencing their programme of work. Please remember that Reporting Accountants are under a duty pursuant to Section 34(9) of the Solicitors Act 1974 and the terms of their engagement with firms to immediately report to us any evidence of theft or fraud or significant concerns about the fitness and propriety of the firm to hold client money (see also Rule 35.1 of the Accounts Rules). The duty also extends to reporting to us a termination of the Accountant's appointment based on an intention to issue a qualified Accountant's Report. If the Reporting Accountant considers that their work has been limited in scope to the extent that they feel unable to make the declarations required on the Accountant's Report form, then they should qualify the report on that basis. We have recently extended the obligation to also inform us immediately if the Reporting Accountants discover a failure by the firm to submit a previously qualified Accountants' Report to us as required by the Accounts Rules (see Rule 32).

About this Guidance

This Guidance has 3 sections:-

- the provisions of the Accounts Rules that need to be considered by the Reporting Accountant and which need to be covered by the Accountant's Report
- the sorts of factors which we consider may lead to notification of issues and hence submission of the Accountant's Report
- a table setting out some examples of the types of checks or test procedures that may be undertaken by the Accountants and some guidance about the types of results/situations the Accountants and the firm's COFA and managers may expect to see in an above adequate, adequate and below adequate firm.

SECTION 1

We only require Reporting Accountants to assess compliance with the provisions of certain elements of the Accounts Rules. These provisions are set out below:

- Rule 1 – The overarching objective and underlying principles
- Rule 7 – Duty to remedy breaches
- Rule 13 – Client accounts
- Rule 14 – Uses of a client account
- Rule 17 – Receipt and transfer of costs
- Rule 18 – Receipt of mixed payments
- Rule 20 – Withdrawals from a client account
- Rule 21 – Method of and authority for withdrawal from a client account
- Rule 27 – Restrictions on transfers between clients
- Rule 29 – Accounting records for client accounts.

If the circumstances outlined in Rule(s) 8, 9, 10,15, 16 and 19 are applicable the Accountant is required to assess compliance accordingly.

SECTION 2

In view of the intention to rely on the Reporting Accountants' professional judgement, we do not consider it appropriate to define when a report **must** be qualified. The assessment requires an understanding of the seriousness of all the risks posed in the context of the firm's size and complexity, areas of work, systems and controls and compliance history. However, there are some areas where both our and the Reporting Accountants' experiences shows a risk to client money and which we would therefore expect may lead the Reporting Accountant to consider a qualification. Notwithstanding these matters, if the Reporting Accountant identifies a matter that he/she considers should be drawn to the attention of the SRA, the report should be qualified and submitted to the SRA. A law firm should not seek to prevent a Reporting Accountant from qualifying a report on the basis that the qualification does not fall into the factors set out below.

These factors (which are illustrative only and not intended to be exhaustive) include:-
Serious factors – the presence of one or more is likely to be material and/or represent a significant weakness in the firm's system and controls, and lead towards a definite qualification:-

1. A significant and/or unreplaced shortfall (including client debit balances or office credit balances) on client account, including client monies held elsewhere unless caused by bank error and rectified in a timely manner (see sections 3.1, 3.2 below).
2. Evidence of the wilful disregard for the safety of client funds by such action as the deliberate overriding of the SRA Accounts Rules 2011 and/or Accounting Guidelines.
3. Actual or suspected fraud or dishonesty by the managers or employees of the firm (that may impact upon the safety of client funds).
4. Material breaches have not been reported by the firm to us in accordance with the Authorisation Rules or the separate duty to report serious failure to comply with the rules in the SRA's Handbook or serious misconduct by any person in accordance with Outcome 10.3 and 10.4 of the Code of Conduct. This is in respect of material breaches that the Accountant becomes aware of as a result of work undertaken in respect of client money. A detailed assessment of the firm's financial position is not required.
5. No or wholly inadequate accounting records or records not retained. (Rule 29.17).
6. Significant failure to provide documentation requested by the Reporting Accountant.
7. Three way client account bank reconciliations not carried out (Rule 29.12).

8. Client account used as a banking facility (Rule 14.5).

Moderate factors – the presence of which one or more may be material and/or represent a significant weakness in the firm's systems and controls, and lead towards a potential qualification:-

1. A significant, fully replaced shortfall (including client debit balances or office credit balances) on client account, including client monies held elsewhere unless caused by bank error and rectified in a timely manner (see sections 3.1, 3.2 below).
2. Actual or suspected fraud or dishonesty by third parties that may impact on the safety of client funds
3. Material breaches that have not been reported to us within one month of identification in accordance with the Authorisation Rules.
4. Accounting records insufficient or unreliable (Section 3.7 below) or not retained for 6 years (Rule 29.17).
5. Three way client account bank reconciliations not regularly carried out at least every 5 weeks (Rule 29.12).
6. Poor control environment (Sections 3.3, 3.4, 3.5, 3.6 below).
7. Performance or review of three way bank reconciliations not adequate (Section 3.7 below).
8. Longstanding residual balances due to clients (Section 3.8 below).
9. Improper use of suspense accounts (Section 3.9 below).

SECTION 3

The purpose of this section is **not** to provide a mandatory or definitive list of all test procedures required to be performed in all circumstances by the Reporting Accountants. Its aim is to provide some examples of the sorts of areas of work that might be used by the Reporting Accountants to test compliance with the relevant Accounts Rules as set out in Section 1.

In all cases, we suggest that the Reporting Accountants discuss with the firm in advance the areas that they intend to cover in their work programme. It is, however, the Accountants' responsibility to ensure that the work they undertake is sufficient to enable completion of the Accountants' Report and proportionate and targeted to the size of firm and nature of its work. Detailed below is an overview of some of the key rules and areas that the Reporting Accountant **may** wish to cover when planning the work they will undertake. Appropriate planning by the Accountant may mean that testing in one area may cover issues of compliance in other areas. For example, by checking the client account bank reconciliation it may be possible to be satisfied that a number of the key rules are being complied with. Again the examples are not mandatory and are intended to be helpful to both the Accountants and the firms concerned.

The section also includes some guidance on what processes and procedures the Reporting Accountant may expect to see in an above adequate, adequate and below adequate firm. These are included to assist both the Accountant and the COFA and managers responsible for compliance with the Rules in knowing what good, average and poor looks like but we would only expect firms in the below adequate section to lead to the issue of a qualified report and if the factors set out in section 2 above are present.

Outcome of Reporting Accountant test procedures	**General guidance**	**Examples of areas of focus (work should be proportionate, not all of these will**	**Guidance – indicative of firm with above adequate processes and**	**Guidance – indicative of a firm with adequate processes and controls**	**Guidance – indicative of a firm with below adequate processes and controls**

		always be relevant. Accountants should use their judgement in performing suitable work. Checking compliance with the Rules may be achieved by carrying out a selection of tests)	**procedures**		**that may lead to a qualification**
3.1 Client money in client account Have you seen any evidence of the placing of client money in any account or location other than a client bank account, or any delay in the placing of money into a client bank account, for a period of time that has resulted in a loss to a client or would otherwise give you concerns about potential fraud or losses to	A delay of 5 working days over that required by the rules is considered likely to result in a loss to the client or is evidence of a lack of attention or focus on the rules, which require client money to be banked 'without delay' or to be transferred within 2 or 14 days. Round sum transfers between the client account and the office account may be indicative of client	• Testing of office account receipts (to assess if receipts include client money). • Testing whether client money identified in the office account was transferred in accordance with the rules. • Testing whether client money received was banked in accordance with the rules. • Testing	No incidents noted of client money being placed in any account or location other than a client bank account. No incidents noted of delays in placing client money into a client bank account (these include money in an office account that becomes client money through, for example, overpayments, credit notes issued to clients in respect of paid bills and cancelled cheques on	Minimal incidents of client money being placed in any account or location other than a client bank account. In such incidents, the law firm rectified the issue promptly (within 5 working days), transferring client money to an appropriate client bank account. No incidents noted of banking client money into a client bank account with a delay of in excess	• Client money was routinely placed in an account or location other than a client bank account and/or there were delays of over 5 working days above that required by the rules in transferring these funds to a client account. • Incidents were noted of a delay in excess of 5 working days in

client money? Have you seen any round sum transfers between the client account and the office account ?***Rule 7, Rule 13, Rule 14, Rule 17, Rule 18***	monies being improperly used to finance business operations. .	office account to client account transfers to identify number and reasons for such transfers. • Testing client bank reconciliation (for example, to assess if reconciling items lead to banking of client money outside the timeframes in the rules or to identify round sum transfers in breach of the Rules). • Testing office bank reconciliations (for example, to assess if reconciling items lead to banking of client money in the office account or to identify round sum transfers not required).	disbursements). No incidents noted of transfers between client accounts and the office account that were not within the Rules and appropriately authorised.	of 5 working days (these include money in an office account that becomes client money through, for example, overpayments, credit notes issued to clients in respect of paid bills and cancelled cheques on disbursements). No incidents noted of transfers between client accounts and the office account that were not within the Rules and appropriately authorised.	banking of client money into a client bank account (these include money in office account that becomes client money through, for example, overpayments, credit notes issued to clients in respect of paid bills and cancelled cheques on disbursements). • Round sum amounts were transferred out of client account without both authorisation and proper reason (for example, payment of a bill or a disbursement).

3.2 Overdrawn client /credit office ledgers - shortages Have you identified any debit balances on client ledgers, or credit balances on the office ledger, for a period of greater than 14 days that indicate: • the firm has used other clients' money on client matters; • client money has not promptly been placed in a client account; or • client money being inappropriately withdrawn from client account. ***Rule 7, Rule 13, Rule 14, Rule 17, Rule 18,***	Law firms should have controls to avoid client debit balances arising and that prompt a regular review and investigation of office credit balances.	• Test the computerised system to assess if debit balances can be created (for example, by processing a payment in excess of the balance held on client account in respect of a particular client). • Where debit balances can be processed, test debit balances that arose throughout the period and assess the timeframe taken to remove the debit balance – also understand why the debit balance arose. • Test documentation that supports regular	Systems and practices are such that debit balances do not arise. A listing of credit balances on the office ledgers is reviewed at least weekly and each credit balance is investigated, fully understood and action taken where necessary to remove client funds in office account.	Debit balances on client ledgers are reviewed at least weekly and necessary action taken to remove the debit balance. A listing of credit balances on the office ledger is reviewed at least monthly and each credit balance is investigated, fully understood and action taken where necessary to remove client funds in office account.	• There are no processes in place that would routinely identify debit balances on client ledgers. • Debit balances that are identified through ad-hoc procedures are reviewed but either no action is taken to investigate and properly remove the debit balance or such action is not undertaken for over a month from the date of identification. • There are no processes in place to identify credit balances on the office ledger. • Office credit balances that are

Rule 20, Rule 21, Rule 27, SRA Guideline 2.7 and 4.5		review of office credit balances and check that action is taken to remove necessary office credit balances within one month of the date on which it was identified. • Test office credit balances arising in the year to assess if any indicate that client money was in office account for an inappropriate length of time.			identified through ad-hoc procedures are reviewed but either no action is taken to investigate and properly remove the credit balance or such action is not undertaken for over a month from the date of identification.
3.3 Withdrawals from client account Are withdrawals of client money made only in accordance with pre-approved authorisation procedures? ***Rule 20,***	It is important to check if payment withdrawals are made in accordance with authorisation procedures.	• Test a sample of client account withdrawals to assess if appropriate client account withdrawals authorisations were in place at the time of the withdrawal	A formal client account withdrawals process is fully documented and adhered to. Withdrawals can only be processed once the proper authorisation has been obtained.	A client account withdrawals process exists and is adhered to, but is not formally documented. Withdrawals can only be processed once the proper authorisation has been obtained.	• A client account withdrawals process does not exist. • A client account withdrawals process exists but is not adhered to. • Unauthorised withdrawals from

SRA Guideline 4.1		. • Consider whether unauthorised withdrawals could be indicative of fraud/dishonesty	Where electronic authorities are permitted, these are only made with a secure IT approval process (note: email approval is not considered secure).		client bank account have been identified.
3.4 Control systems Can the firm demonstrate that it has effective processes (both manual and IT) that are designed to ensure the integrity (i.e. working order) and security (access) over client accounting records and money? ***Rule 29, SRA Guideline 5.5***	Effective IT systems may include – access controls, firewalls, software and hardware maintenance contracts. Effective manual systems may include – a system of operating controls to prevent misuse of client money and monitoring controls that would identify such misuse.	• Obtain documentation about how the firm controls their IT environment. • Ask the firm to demonstrate either by providing you with a copy of their, or by showing you, their IT access controls. • Accountants are not expected to perform extensive work around the IT or manual control environment at the firm. But rather are expected to report	A strong control environment exists which includes the following: - The client accounting system is fully documented and includes notes over billing, payments, transfers, new client take on, etc. - Password access to the IT system/s and passwords are changed at least quarterly. - IT user access controls are in place. - Program changes to the IT system are always fully documented and approved	A reasonable IT control environment exists which includes the following: - Password access to the IT system/s and passwords are changed at least annually. - IT user access controls are in place. - Program changes to the IT system are always fully documented and approved before changes commence. - Leavers ID's and passwords are removed from the IT system within one month of the individual leaving the	• The control environment does not include characteristics of the "adequate process and controls" noted opposite (*Note: the controls should be commensurate to the size and complexity of the law firm).* • The accountant has identified, through their work, a control environment that is ineffective or not fit for purpose.

		any results based on the work that they *have* done	before changes commence. - Leavers ID's and passwords are immediately removed from the IT system once they have left the law firm. - Firewalls are in place. - IT general controls are documented to a standard that is commensurate with the size and complexity of the business.	law firm. - Firewalls are in place. - IT general controls are documented to a standard that is commensurate with the size and complexity of the business. - The client accounting system is not fully documented, but notes exist which support the necessary cycles, e.g. billing, payments, transfers, new client take on, etc.	
3.5 General control environment Have you seen any evidence where the systems have not operated effectively or where the firm has not been able to properly account to clients for client money held? ***Rule 7, Rule 13, Rule 14, Rule 17,***	The COFA or a member of the finance team should (reporting results to the firm's managers) regularly review systems and processes and ensures they are fit for purpose in accordance with the requirements of the Rules. Reporting structures within the	• Consider the firm's breaches register, the extent to which breaches are recorded, followed up. Reviewed, action taken. • Consider previous Accountant's reports. • Consider previous years' Accountant's reports and matters	The COFA or a member of the finance team reviews the systems and processes at least annually and implements actions for improvement where appropriate. The COFA ensures action is taken for all issues included in the Accountant's Report (and any subsequent	The COFA, a member of the finance team or the Internal Audit team reviews the systems and processes every two to three years and implements actions for improvement where appropriate. The COFA ensures action is taken for all issues included in the Accountant's	• There is no formal review of the systems and processes. • No action is taken from the findings included in the Accountant's Report or any separate report issued to management. • Also see points under 3.7

Rule 18, Rule 29, SRA Guidelines	firm should be such that accounts staff readily report errors and systems weaknesses to the COFA.	reported in those, where appropriate. • Internal audit • Complaints by clients? • Review list of non-moving client account balances	or additional work commissioned by the firm Also see points under 3.7 below.	Report (and any subsequent or additional work commissioned by the firm Also see points under 3.7 below.	below.
3.6 General Compliance with the Rules Have you seen evidence of management review/controls designed to ensure compliance with the SRA Accounts Rules? ***SRA Guidelines***	Firms are required to undertake three way reconciliations between the bank, cash book and client ledger listings at least every 5 weeks. There should be an evidenced, timely review of such reconciliations. Recommended processes would include regular staff (finance **and** legal professionals) training, breach log review, exception reports.	• Testing of client bank account reconciliations, office bank account reconciliations, the three way reconciliation of the cash book, client ledger listing and bank accounts and the breach register (to assess if they have been reviewed by at least the COFA or another appropriate individual). • Where reconciling items appear on two	The COFA, or another appropriate individual within the firm, performs a review on more than one occasion each month, of SRA Accounts Rules compliance, including a review of (i) client bank account reconciliations, (ii) office bank account reconciliations, (iii) three way reconciliation of the cash book, client ledger listing and bank accounts; and (iv) breach register. Evidence exists of challenge by	The COFA, or another appropriate individual within the firm, performs at least a five-weekly review of SRA Accounts Rules compliance, including a review of (i) client bank account reconciliation, (ii) office bank account reconciliations, (iii) three way reconciliation of the cash book, client ledger listing and bank accounts; and (iv) breach register. Challenge by the COFA happens, but no evidence	• No or insufficiently frequent bank reconciliations are undertaken • There is no review of one or more of the bank reconciliations or the breaches register. • The COFA, or another appropriate individual within the firm, performs ad-hoc and/or informal review of SRA Accounts Rules compliance, including a review of

		consecutive monthly reconciliations, check that that they have been identified, challenged and appropriate steps have been taken to remove them. • Review of documentation supporting reviews performed by the COFA over the client money control environment.	the COFA and actions taken to improve the control environment. The COFA, or another appropriate individual within the firm, performs a review annually, or as appropriate, of the client money control environment and, where appropriate, takes action to improve processes. The COFA, or another appropriate individual within the firm, performs a detailed annual review of the training requirements for staff – both finance and legal professionals and ensures appropriate training is delivered to these individuals. If it is not the COFA who performs these tasks,	exists to support this. The COFA, or another appropriate individual within the firm, performs a review annually, or as appropriate, of the client money control environment and, where appropriate, takes action to improve processes. The COFA, or another appropriate individual within the firm, performs a detailed annual review of the training requirements for staff – both finance and legal professionals and ensure appropriate training is delivered to these individuals. If it is not the COFA who performs these tasks, there should be evidence of reporting to and review	(i) client bank account reconciliation, (ii) office bank account reconciliations, (iii) three way reconciliation of the cash book, client ledger listing and bank accounts; and (iv) breach register. No challenge or action is taken by the COFA. • The same reconciling item (other than un-presented cheques) appears on two consecutive monthly bank reconciliations without clear evidence that it has been challenged by the COFA • The COFA, or another appropriat

			there should be evidence of reporting to and review by the COFA.	by the COFA.	e individual within the firm, does not perform an ad-hoc review at least annually of the client money control environment or does not take action, where appropriate, to improve processes. If it is not the COFA who performs these tasks, there is no evidence of reporting to and review by the COFA.
3.7 Accounting records Does the firm operate a system that allows accounting records to be maintained in an up-to date manner and in compliance with the Rules ***Rule 29, SRA Guideline***	Processes in place are designed to ensure between daily and weekly postings of transactions (depending on size of firm). Exceptions may arise due to circumstances where transactions are outside the ordinary course of	• Testing of client account receipts, payments, transfers. • Testing of office account receipts, payments and transfers. In all cases, this would be to assess if accounting records	All client and office transactions are posted to the accounting system by the end of the next working day. The law firm would, at all times, be able to account to clients for client money held.	All client and office transactions are accounted for, either in the system or through an alternative system (e.g. through use of spreadsheet before batch processing in the system) by 5 working days following the transaction.	• Client and office account transactions are routinely posted to the client account system in excess of 5 working days after the date of the transaction. • The firm does not have an

2.3	business – evidence should exist of law firm's timely investigation and follow up of such items.	have been kept up to date under the appropriate timeframes. • Consider if the firm is able to, quickly and easily, account to clients for money held on their behalf.		The law firm would be able to account to clients for client money held.	accounting system that is commensurate with the size and complexity of the business and, as a consequence, cannot account to clients accurately for monies held.
3.8 Failure to account Have you seen evidence of firms failing to return client money at the end of the matter? ***Rule 14.3 and rule 14.4***	Residual client balances should be returned to clients at the end of a matter. Where this is not possible, there is clear documentation retained which supports the efforts made to return residual client balances.	• Test the exception report of residual client balances to check that the firm has complied with the Rules. • If no exception report exists, obtain a listing of client matters where no time has been charged for at least 90 days and assess if residual client balances exist and the firm	Residual client balances are always returned to clients at the end of a matter and, thus, residual client balances at any one time are rare.	Residual client balances are returned to clients, although, this can take up to 90 days. Residual client balances do exist at any one time; however, the finance team are aware of all of these and are in the process of returning the funds or of dealing with them in accordance with Rules 20.1 (k) and/or Rule 20.2.	• The firm has no effective system in place for complying with Rules 14.3 and 14.4. • Significant – either in themselves or cumulatively - residual client balances are common and the firm cannot therefore return them to clients

		has complied with the Rules.			
3.9 Suspense ledgers Have you seen evidence of inappropriate use of a client suspense account? ***Rule 29.25***	Where suspense accounts are used, this should be for temporary items only such as an unidentified receipt or payment.	• Identify if suspense accounts are used (recognising that they may be called alternative names such as miscellaneous or in the names of the Partners) • Test the balances outstanding to check that they were posted for good reason and, if they are longstanding, that there has been appropriate review/challenge and an effective plan in place for their closure.	Where suspense accounts are used, items are usually no more than 5 working days old.	Where a suspense account is used, items are usually no more than 30 working days old.	• Widespread unjustified use of suspense accounts. • No process for clearing suspense accounts or outstanding items not followed up.

Annex 5

Report on consultation responses and SRA conclusions – Overseas Rules.

RESPONSES TO CONSULTATION

1 On 30 September 2014 we issued a consultation document seeking views on proposals to modify the rules in relation to overseas accounts. The proposals were designed to ensure that regulation is proportionate and targeted, with the aim of reducing costs for legal services providers.

2 The consultation closed on 22 December 2015. This report summarises the key points emerging from the responses.

3 A summary of the answers to the questions posed is set out below. A breakdown of the composition of respondents and a list of those respondents who consent to their details being publicised is contained below.

Question 1: Do you agree with our proposal to relocate the new overseas accounts provisions from the SRA Accounts Rules 2011 into the Overseas Rules? Is anything lost in doing so?

4 The majority of respondents agreed that the accounts provisions should be moved into the Overseas Rules. One respondent argued that taking the overseas accounts rules out of main accounts rules would mean that offices overseas would no longer be clear on whether or not to use SRA Accounts Rules as guidance if they were unsure about interpreting the existing overseas rules. A number of other respondents, however, argued that one of the benefits of a clearer separation between overseas and domestic accounts rules was to avoid the application of inappropriately detailed domestic rules in an international environment.

Question 2: Do you agree with the proposed changes to the application of these overseas accounts rules? More practices will be covered by the new rules, but it should be easier to understand what does and does not apply.

5 Respondents all agreed that the current application of the overseas accounts rules was too complex and caused overseas practices to fall in and out of coverage by the rules.

Question 3: Do you agree with our proposed simplification of the substance of the overseas accounts rules, as set out in new overseas rule 5.1, when compared to rules 50.3-50.6 in the existing Solicitors Accounts Rules?

6 There were a number of detailed comments made by respondents on the proposed substance of overseas rule 5.1. As a result of the responses we have added provisions relating, for example, to the treatment of interest and to unclaimed client balances.

Question 4: Do you agree with our proposed new definition of client money overseas? Are there any concerns about risks this might pose either to consumers or third parties?

7 There was widespread disagreement with our proposed new definition of *client money overseas*, which was felt to be insufficiently clear. However, a number of respondents suggested some useful alternative drafting which we have adopted and which achieves the objective of broad compatibility with the definition of *client money* applying domestically, thus ensuring the same level of consumer protection, for example in relation to withdrawals from client account..

Question 5: Do you agree with our proposal to eliminate the requirement for accounts to be automatically submitted in respect of overseas practices?

8 Some of the respondents were unhappy about removing the standing requirement for accountants' reports in relation to overseas practices holding client money. However, these concerns either related to an apparent contradiction with the approach taken domestically or to a concern that overseas practices were somehow 'more risky' and therefore needed to be more closely monitored and to have a 'deterrent' effect in place.

9 In reviewing these concerns, we took into account the evidence on the accountants' reports from overseas practices which we had received over the past five years and the fact that the rules governing accounts overseas will now be embedded in the overseas rules which has its own reporting obligations.

Respondents to the Consultation

Type of respondent	**Responses**
Law firms / solicitors	2
Accountancy firms	1
Representative groups, trade and membership associations	2
Local Law Societies	1
TOTAL	6

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

Representative groups, trade and membership bodies, professional bodies

Junior Lawyers Division's of The Law Society
The Law Society

Local Law Societies

City of London Law Society