SRA BOARD
15 July 2015

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Reporting accountant requirements

Purpose

1. To seek the Board's agreement to make changes to the reporting accountant's requirements in the SRA Accounts Rules 2011 (the 'Accounts Rules').

Recommendations

2. The Board is asked to:

   (a) note the report summarising the outcome of our consultation on the reporting accountant's requirements attached at Annex 1 (paragraphs 5 to 8);

   (b) note the new guidance for reporting accountants (Annex 3) and the new accountants report form (Annex 4) (paragraphs 9 to 38);

   (c) to agree to extend the categories of lower risk firms exempt from the requirement to obtain an accountant's report to include those who, during the relevant accounting year have had an average client account balance of £10,000 or less, and a maximum client account balance of £250,000 or less (paragraphs 39 to 61); and

   (d) to make the amendments to the Accounts Rules under rule 2 of the SRA Amendments to Regulatory Arrangements (Accountant's Reports and Overseas Rules) Rules) [2015], with the exception of the changes to Part 7 of the Accounts Rules (Annex 2). (paragraph 64).

If you have any questions about this paper please contact Crispin Passmore (crispin.passmore@sra.org.uk or 0121 329 6687)

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15 July 2015

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Reporting accountant requirements

Accounts Rules– phase two of changes to reporting accountant requirements

Background

3. The SRA Accounts Rules 2011 (the 'Accounts Rules') place a requirement on firms holding client money to obtain an accountant's report on an annual basis relating to their compliance with the requirements of those rules, and to submit this to the SRA. In July 2014, the SRA Board agreed to a phased approach[1] to reforming these reporting accountant requirements, with the aim of achieving a more proportionate and targeted approach to the overarching objective of keeping client money safe[2].

4. Phase 1 of those reforms came into effect on 31 October 2014[3]. This made minor changes to the format of the accountant's report and introduced an exemption for certain firms from the requirement to obtain a report, and, for all firms, removed the requirement to submit reports to us unless these were qualified.

5. The Phase 2 consultation was issued on 18 November 2014 and closed on 28 January 2015.[4] The consultation made a number of recommendations designed to, amongst other matters, remove the level of prescription we impose on the way accountants assess compliance; and to exempt a greater number of low risk firms from the requirement to obtain a report.

6. We received 42 responses to this consultation, including from the Law Society[5], four local law societies, the Institute of Chartered Accountants in England and Wales (ICAEW) and a number of individual accountancy and SRA authorised firms. A summary of the responses is attached as Annex 1.[6]

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[1] The SRA first consulted on its proposals for changes to the reporting accountant requirements in May 2014. The consultation closed on 19 June. A copy of the consultation paper and a summary of responses can be found here http://www.sra.org.uk/sra/consultations/reporting-accountant.page

[2] Rule 1.1 of the Accounts Rules.

[3] SRA Amendments to Regulatory Arrangements (Accountants' Reports) Rules [2014] were made by the SRA Board at its meeting on 17 September 2014

[4] See http://www.sra.org.uk/sra/consultations/reporting-accountant-requirements.page

[5] See http://www.lawsociety.org.uk/policy-campaigns/consultation-responses/reporting-accountant-requirements/

[6] Copies of all of the responses are available to Board members on request.

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7. In light of a preliminary analysis of the responses, at its meeting on 11 March 2015[7] the Board agreed in principle to a number of proposals, summarised in more detail in the paragraphs below. However, at that time, the Board identified that further work was required in order to develop guidance for reporting accountants on the new approach, and to analyse the categories of firm which might be considered for inclusion in the "low risk" exemption. This further work has now been carried out and we are therefore bringing these proposals back before the Board, as set out below.

8. Further, the Board took on board concerns raised in the consultation about the suggestion that the new approach should be implemented in April 2015, in light of the interim work that would already have been carried out at that time by large firms under the current arrangements and the limited time available for accountants to get to grips with the new process. Therefore, as per the decision of the Board in March, it is now proposed that any changes will be implemented in 1 November 2015, with the new rules applying to all firms with accounting periods ending on or after that date.

Recommendation: the Board is asked to note the report summarising the outcome of our consultation on the reporting accountant's requirements attached at Annex 1.

Summary of proposals in phase two of the consultation on reporting accountant requirements

Amending the assessment process and reporting format to remove prescription and place more emphasis on accountants' professional judgment

9. As highlighted in our May 2014 consultation, over 9,000 reports are carried out annually and over 50% of them are qualified: reports may be qualified for a range of reasons, from minor breaches through to more significant problems. Minor breaches may include short delays in posting money to the client account, wrongly posting a payment that is subsequently corrected, or an amount being wrongly allocated between office and client account. From the total number of reports received, 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.[8]

10. Although the Accounts Rules 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

[7] http://www.sra.org.uk/sra/how-we-work/board/public-meetings.page

[8] Consultation: Reporting Accountant Proportionate regulation: changes to reporting accounting requirements: May 2014" paragraph 5.

prescribed in the Accounts Rules 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.

11. The responses to the May 2014 consultation highlighted the need for a review of these detailed tests to ensure that reports are fit for purpose and place only proportionate burdens (and therefore cost) on the firms concerned.

12. While some minor amendments to the format of the report had been made as part of phase 1, we considered that more comprehensive reform was needed. Therefore, the main proposal in the consultation was to amend the Accounts Rules 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 and to allow accountants to exercise their professional judgment in relation to the matters they report. These requirements are principally set out in Rule 39, and include detailed prescriptions in relation to the sampling that accountants must carry out[9].

13. The consultation contained an amended version of the format of the report with a draft of how the Accounts Rules could be changed to reflect this new approach. The revisions, in particular to Rule 39 asked the reporting accountant to carry out work to ascertain whether the firm has maintained an effective system for accounting for client money which has enabled the firm to comply with the Accounts Rules. Our view was this approach would lead to fewer firms having their accounts qualified for trivial breaches and would focus the reports on issues that present a real risk to client money.

Overall approach

14. Although a few respondents opposed the changes in principle (with one solicitor stating 'It is not self-evident that accountants are particularly good at spotting a risk to client money'), there was widespread welcome for the proposals and general agreement that the current regime requires amendment.

15. The Law Society stated: "….the exercise of greater professional judgment in qualifying reports will help to ensure that only when client money is at risk and/or there are serious breaches are reports qualified. This will make the information of more value to the SRA". We agree that we should only use our regulatory powers to require information that is of value to us in exercising our regulatory functions.

[9] http://www.sra.org.uk/solicitors/handbook/accountsrules/part8/rule39/content.page

16. Another response which supports this view came from a leading firm of accountants, which stated "We agree with the premise that the Reporting Accountant should be allowed to apply greater professional judgement when completing a firm's Accountant's Report. We concur that under the current Rules and guidance, reporting to the SRA is limited in terms of how much context or emphasis comes through in the reporting as it is focused purely on factual breaches of the Rules and therefore contains a lot of matters which, whilst breaches of the Rules, may not be of particular concern or significance to the SRA."

16. That accountancy firm went on to highlight the benefits in terms of compliance, stating: "one of the potential advantages of this proposed form of reporting is that the Reporting Accountants 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. If the Reporting Accountant's role is to change in this way, it should mean that a COFA would have the chance to receive constructive feedback from the Reporting Accountant that would then allow them to improve the control environment in a way that supports their objectives as a COFA".

17. The Sole Practitioners Group highlighted the potential efficiency and cost savings, stating "Professional people work much more effectively without specific guidance and using their discretion. Hopefully they will work more efficiently and therefore more cheaply in providing the same level of protection for both firms and the public in relation to the legend of the client account'.

18. The City of London Law Society expressed its support for the proposals, stating: 'The level of prescription in the current rules has often tended towards a standardised, "tick box", approach which does not necessarily address the specific risks to client money presented by any particular firm. We are broadly supportive of the proposal that this prescription should be removed. We also support the proposal that the reporting accountant should have scope to exercise professional judgement, both to design an inspection programme around the specific risk profile of each firm, and in deciding what is a material threat to the safety of client money and thus requires reporting to the SRA. It is right that the SRA should feel able to place reliance on that professional judgement.' We agree that the proposals allow the reports to be targeted towards areas of risk, and focused on our overarching aim, to keep client money safe.

19. For the reasons set out above, we therefore consider that we should proceed to introduce the changes to amend the format of the accountants' reports and the level of prescription in the Accounts Rules regarding the tests and controls accountants are required to carry out. This proposal was agreed in principle by the Board in March 2015. We have now drafted amendment rules to implement these changes, attached at Annex 2.

20. However many respondents did have a number of concerns and suggestions about the implementation of the proposals, which we have taken on board, as follows:

Obligations on the solicitors firm

21. The Solicitors Disciplinary Tribunal (SDT) stated that 'a perception that responsibility for "getting it right" has been moved from the solicitor to the accountant may result in a weakening of the system. Solicitors may be tempted to blame (rightly or wrongly) their accountants for their own shortcomings in the event that enforcement action is taken by the SRA as a result of the accountant's report. This "blame game" already happens in some cases before the Tribunal. The move in emphasis towards reliance on the accountant's professional judgement may encourage more complex, hotly-disputed disciplinary proceedings involving accountants to a greater degree than now. The risk of satellite litigation is increased. This risk may be minimal; the majority of accountants (like the majority of solicitors) take their professional responsibilities very seriously and are regulated. It is however a risk worth exploring.'

22. We have considered this issue, and do not consider that this risk is materially increased by the proposed changes. The obligations to comply with the Accounts Rules remain with the solicitor's firm and have been unaffected by these changes. .

23. Further, as the SDT indicates, 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).[10] They will have professional obligations (for example to make proper examination of records) that should help ensure that their findings are properly evidenced and therefore the risk identified by the SDT does not materialise. Alternatively, the guidance for reporting accountants (Annex 3) 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. We will however, keep this matter under review in light of SDT cases arising from concerns raised by accountants under the new regime.

Guidance

24. Respondents identified the need for us to develop guidance on the matters that should be covered in any amended accountant's report, in discussion with stakeholders. It was widely felt that such guidance would support consistency, and, without such guidance, uncertainty would lead to greater costs as accountants designed their own procedures.

[10] See Rule 34.1

25. We agreed with respondents about the need for further guidance and the need to engage fully before finalising it. We therefore set up an external working group, which included the Law Society, the Sole Practitioners Group, the City of London Law Society, ICAEW and a number of the individual accountancy firms that had responded to the consultation.

26. The new draft guidance (Annex 3) and revised accountants' report form (Annex 4) were discussed and developed in collaboration with that group, and have been amended where appropriate to reflect comments from its members. The guidance is intended for both firms and accountants and subject to any comments from Board members will be published online later this month in order to allow practitioners to familiarise themselves with it prior to implementation.

27. The guidance 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. 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.

<u>Cost</u>

28. Another concern raised with us was the possibility of increased cost of accountant's reports being passed on to firms, There was a feeling from some that a more principles based approach might lead to accountants charging more. For example, the Liverpool Law Society stated "Done properly the new approach will require the accountant to exercise his judgment more than under the old approach, with the accountant taking more time to assess the information he is provided with and ultimately assuming a greater level of risk. The additional time spent and increased risk will be passed on in the fee charged to the firm."

29. The Law Society asked for the cost impact on firms to be assessed and queried whether the current system of checks and tests for undertaking an accountant's report would be acceptable in future, noting that the impact on fees for many firms would therefore be

limited, as many would choose in the short term to continue with the current tests. They added, however, that if there is a need for new sets of procedures to be designed there will inevitably be an additional cost which will be passed on to firms.

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 the time spent on a subsequent report may be significantly reduced."

33. We have carefully considered the points raised in relation to costs, noting that for a number of respondents that raised the issue, the concerns related to the initial stages when accountants where adapting to the new procedures, and can therefore be expected to be linked to the need to provide guidance to assist them in doing so. For example the Association of Chartered Certified Accountants (ACCA stated) "There will be costs to the accountants of understanding the new approach and, possibly, developing / acquiring new systems…..It is ACCA's view that, although in the long term the impact on fees is likely to be negligible, there is the potential for an initial increase in fees charged."

34. Having developed guidance accordingly, we anticipate that any impact on costs will be minimised. Further, we would take this opportunity to emphasise that there is no change to the requirements in the Accounts Rules in relation to how firms should treat client money. This means that firms that are already complying with the rules will not need to introduce any additional procedures.

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Timing

35. Some respondents, including the ICAEW and a leading accountancy firm, felt that there was a need to complete phase 3 of the reforms, which will include a wider review of the Accounts Rules themselves, prior to agreeing any new framework for reporting. Given the SRA's previously stated intention to reform the Accounts Rules, there were worries that these measures would lead to extra costs for accountants and firms coming to terms with a new system which would shortly be subject to more radical change in any event.

36. We consider that these proposals could benefit a number of firms by providing opportunity to adopt practices that are less prescriptive and potentially less costly or burdensome (see, for example the views of the Sole Practitioners Group set out at paragraph 17 above). It will also provide firms that want to improve their processes the opportunity of obtaining a 'tailored' accountant's report (see the comments of the City of London Law Society at paragraph 18 above).

37. We see no reason to deny firms the opportunity of obtaining these benefits now. However if firms wish to agree with their accountants to continue using the current sampling method they are free to do so, provided that this gives the accountants 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.

38. Finally, focusing the accountant's report on the safety of client money rather than on checklists or minor breaches of technical requirements is an approach that reflects our direction of travel for the wider review. Therefore, we consider that any adverse impact of proceedings with these changes now, in light of further amendments that may follow, can be mitigated and is counterbalanced by the benefits the new regime will offer to firms in the meantime. Therefore we consider that it is appropriate to do so.

Recommendation: the Board is asked to note the new guidance for reporting accountants (Annex 3) and the new accountants report form and (Annex 4).

The removal of categories of lower risk firms from the requirement to obtain an accountant's report

39. Following the Phase 1 consultation, 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. Our Phase 2 consultation proposed extending the categories of firms that should be exempt from these requirements, based on the risk they present to client funds. We asked for comments on a proposition that we should exclude firms which hold an average balance of client funds of less than £10,000 in each accounting year.

40. A few respondents opposed any exemptions from a requirement to obtain the report, arguing, for example, that firms could apply for waivers. One firm of solicitors stated "This would seem to indicate that it is thought that 'client's money' in some firms is not as important as 'client's money' in another?" .

41. However this was not the view of the majority of respondents. There was considerable support in principle for the suggested approach of defining additional categories of lower risk firms that would not have to submit accountant's reports. ACCA agreed that the average aggregate balance on a firm's client accounts would be a suitable measure of risk, stating that 'The information would be readily available and the figure easy to determine'. The Sole Practitioners Group agreed, stating that 'there will be minimal risk but it would be at a low level of funds which should not impact to significantly on the public if a default results from a lack of an accountant certificate'.

42. The Law Society, whilst supporting the principle of exempting firms on a risk basis, was concerned that there was insufficient evidence that this category of firms was less risky than those we proposed to continue to require to submit a report. The SDT also cautioned that 'risk-based criteria should be robust and subject to external testing across a range of firms before being implemented, assuming that the objective evidence supports implementation after analysis. However, it must be for the SRA to devise and maintain a system that underpins the regulatory objectives based on that objective evidence.'

43. Respondents made some additional comments. For example, one solicitor respondent suggested we should consider a maximum individual transaction limit; 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.

44. We have taken on board these concerns and have carried out an analysis of client money information supplied by firms as part of the Practising Certificate Renewal Exercise (PCRE) in autumn 2014 which includes average, maximum and minimum balances. This 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, including some firms with a maximum over £1 million.

45. We therefore agree 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 recommend 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.

46. 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 have exempted 1,014 firms from the need to file an accountant's report based on data we collected as part of the November 2014 PCRE. This is around 13% of firms who reported holding client money.

47. Our impact assessment, at Annex 5, sets out a number of comparisons we made of the relevant risks posed by this sample group of firms compared to the general population of firms that hold client money[11]. As set out in that statement, the following conclusions were drawn:

- whilst 58.8% of all firms (open for at least two years) had filed qualified accounts in a two year period, the proportion amongst the sample firms was much lower at 37%;
- 14.6 % of all firms had certain matters, narrowly connected with accountants' reports, received against them in the two years 2013 and 2014 in this category, whilst the proportion was 7.4% for the sample firms;
- 0.7% of all firms had a matter in this category upheld against them in the same two year period, the proportion was lower for sample firms (0.2%); and
- using a wider definition of financial matters, 3.5 % of all firms (3.7% of non sample firms) have had such matters upheld against them in a five year period. compared to 1.6% of sample firms.

48. 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 believe that our analysis of the data provides sufficient reassurance on this issue without the need for further external testing.

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

49. 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). 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.

50. Further, it is worth highlighting that the Accounts Rules give 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 impose immediate conditions requiring them to obtain reports on an annual or more frequent basis if the risk posed requires such action[12]. 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.

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

52. In light of comments by respondents (such as the Law Society) that we should look carefully at risk categories, 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 more risky than others. 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.

[12] See Rule 32.2

53. As we stated in our consultation document, we will 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.

54. 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 (these firms were put forward as another possible exemption in the consultation paper, and there was some support for this). However we consider that the great majority if not all of these firms will be included in the proposed exclusion category in any event due to the low amounts of client money held.

55. We therefore propose to exempt firms from the requirement to obtain an accountant's 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. As suggested by respondents we propose to 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.

56. Firms are already used to collating this data for PCRE so the burden of doing so for these purposes should be lessened. We are nevertheless considering whether firms should be obliged to positively confirm on PCRE from 2016 onwards where they meet the exemption criteria. The information that firms already provide on PCRE as to average client balances and maximum balance over the preceding 12 months will provide a useful cross check, but this may not match the firm's accounting period.

57. We also propose to review the way the exemption operates in practice, and keep the category of exemptions under review.

Recommendation: the Board is asked to agree to extend the categories of lower risk firms exempt from the requirement to obtain an accountant's report to include those who, during the relevant accounting year have had an average client account balance of £10,000 or less, and a maximum client account balance of £250,000 or less.

Other consultation questions

58. The consultation raised a number of questions around signature and submission of accountants' report which reflect issues raised with us in the course of the previous consultation and discussions. These were:

    a. whether the firm should sign an annual declaration of compliance with the Accounts Rules;

b. whether the existing obligations on reporting accountants to notify us immediately of significant concerns during the course of preparation of their reports needed to be tightened or enhanced in light of our proposals; and

c. whether we should transfer the obligation to submit the reports to us from the firm (where it currently rests) to the reporting accountant.

Finally we asked respondents for themes or specific issues that we should consider in our forthcoming wider review of the Accounts Rules.

59. Most respondents concurred with our view that it was unnecessary to ask firms to sign a specific declaration of compliance with the Accounts Rules. The Law Society stated: If a firm fails in its obligation to obtain an accountant's report, it seems likely that they will also fail in their regulatory duty to inform the SRA". Those that did not concur with our view felt that this would be a useful way of focusing the minds of those responsible on the issue. On balance we consider that it is not appropriate to ask firms to sign specific declarations for compliance with the Accounts Rules. This would risk the implication that these were more important than regulatory requirements in other sets of rules – unless we required declarations in relation to each set of rules that they have to comply with.

60. Virtually all respondents, including the Law Society, were clear that the duty to submit the report should remain on the solicitor firm and its managers. Several respondents pointed out that there is already an obligation in the Accounts Rules[13] for accountants 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. We agree that it is important that the obligation to file the report remain with the solicitor – as one respondent stated "You regulate solicitors, not accountants".

61. It was generally felt that the current obligations on reporting accountants to notify the SRA of significant concerns during the course of preparation of their reports were adequate and did not require amendment. As one large firm of accountants commented "We do not think that the existing obligations need to be tightened as Reporting Accountants are already obliged to report on fraud and concerns over the firm's ability to meet its commitments to clients and the SRA"

62. However, 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.' We agree with this suggestion and have included relevant wording in our guidance for reporting accountants at Annex 3.

[13] Rule 35.1

63. The Board agreed in principal, on 11 March, that we should not require firms to make an annual declaration, that the duty to submit reports should remain with the regulated firm and its managers, and that there was no need to enhance the existing obligations on accountants. The decision to make rules in this respect was deferred to this meeting. We have therefore drafted rules accordingly. In response to the Law Society's concerns, these also require the standard terms of engagement for the accountant to include an obligation to notify us immediately if they discover that a previously qualified report has not been submitted to the SRA, and 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).

64. We set out at Annex 2 a copy of the draft SRA Amendments to Regulatory Arrangements (Accountant's Reports and Overseas Rules) Rules) [2015] which incorporate, by virtue of rule 2, amendments to the Accounts Rules to implement all the changes recommended in response to the Phase 2 consultation, as set out in the paper above. It is proposed that the changes come into effect on 1 November 2015, subject to approval from the Legal Services Board. The changes to Part 7 of the Accounts Rules are dealt with in a separate paper before the Board, which considers the position of firms and individuals practicing overseas, and those establishing Exempt European Practices in England and Wales.

Recommendation: the Board is asked to make the amendments to the Accounts Rules under rule 2 of the SRA Amendments to Regulatory Arrangements (Accountant's Reports and Overseas Rules) Rules) [2015], with the exception of the changes to Part 7 of the Accounts Rules (Annex 2).

Next steps

65. The third and final phase of the reforms will involve a wider review of the Accounts Rules as a whole. A detailed timetable for that review has not been set. In the phase two consultation we invited respondents to suggest any specific areas or issues that they would like us to include. The summary of responses at Annex 1 contains details of those issues. These include a general consensus for a move towards a less detailed and prescriptive, more principle-based approach, and a review of the impact of internet banking and development in relation to VAT and third party funding. We will feed these issues into the development of our further consultation proposals.

Solicitors Regulation Authority

SRA BOARD
15 July 2015

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Supporting information

Links to the Strategic Plan and / or Business Plan

66. The proposals are linked to Strategic Objective two: Deliver risk-based outcomes-focused regulation so as to achieve positive outcomes for consumers in the public interest and do so in a way that is justifiable to all our stakeholders.

67. The proposed changes to the Accounts Rules to deliver phase two of a programme of reform are integral to our wider objectives to ensure that regulation is proportionate and targeted, with the aim of removing unnecessary burdens, while providing appropriate levels of consumer protection.

How the issues support the principles of better regulation

68. The recommendations will make regulation more proportionate and targeted by focusing accounting reports on substantive issues where there are risks to client money and by freeing categories of 'low risk' firm from the requirement to submit a report.

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

69. We engaged with stakeholders prior to the consultation and have carefully considered consultation responses. As set out in detail above we then carried out significant further engagement in order to develop the reporting form and guidance for the accountant's report changes.

What equality and diversity considerations relate to this issue

70. The principal consideration relates to the potential impact on small firms of the proposed changes to the Accounts Rules given the slightly disproportionate representation of BAME solicitors and staff in those firms. Overall, the new format of accounting reports is intended to allow a more proportionate approach. This may benefit small firms in particular. The provision of guidance will militate against the risk of accountants' costs increasing for firms, as is our confirmation that existing sampling methods can be used.

71. The removal of categories of low risk firm from the requirement to file the report is likely to particularly benefit smaller firms. Our analysis shows that 21% of all partner equivalents who work at those firms within the sample that would have been exempted firms have BAME ethnicity. This compares to 9% of all partner equivalents who work at firms within the sample that would not have been exempted who have BAME ethnicity. Further details and an analysis of data against other diversity categories are set out in Annex 2. The data suggests that any impacts are primarily a feature of firm size.

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Consumer impact

72. An approach that focusses more proportionately on the risks to clients' money is likely to benefit consumers. It 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.

73. There are a number of protections for consumers built in to the process**:**

    a. 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.[14]

    b. We have performed modelling to ensure that the categories of exempted firm that will no longer be subject to the requirement to obtain the report are those that pose lower potential risks to consumers.

    c. 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 practising certificates and these requirements will remain in place even if the firm would otherwise be within the exempt category.

    d. 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 in all cases a 'ceasing to hold report' to ensure that they have properly accounted for client money.

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

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Date 30 June 2015

[14] See Rule 35.1

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Annexes

Annex 1 Summary of responses to consultation on "proportionate regulation: changes to the reporting accountant requirements"

Annex 2 Draft SRA Amendments to Regulatory Arrangements (Accountant's Reports and Overseas Rules) Rules) [2015]

Annex 3 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 4 Accountant's Report Form

Annex 5 Accountants reports - Impact Statement

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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).[15] 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'.

[15] See Account Rule 34.1

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 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[16]. We also circulated the documents to our small practices and sole practitioner's virtual reference groups for further comments.[17]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

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

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

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'.

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[18].

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[19].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 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.

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

[19] See Rule 32.2

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.'

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15 July 2015

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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

SRA BOARD
15 July 2015

CLASSIFICATION – PUBLIC

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 2

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 (Regulatory Reform Programme) 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.'

SRA Accounts Rules 2011

Preamble

Authority: made by the Solicitors Regulation Authority Board under sections 32, 33A, 34, 37, 79 and 80 of the Solicitors Act 1974, section 9 of the Administration of Justice Act 1985, section 83(5)(h) of, and paragraph 20 of Schedule 11 to, the Legal Services Act 2007 with the approval of the Legal Services Board;

date: 6 October 2011;

replacing: the Solicitors' Accounts Rules 1998;

regulating: the accounts 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, in respect of practice in England and Wales.~~; and~~

~~regulating: the accounts of solicitors, lawyer-controlled bodies and their managers, lawyers of England and Wales who are managers of overseas law firms controlled by lawyers of England and Wales, solicitors who are named trustees, and managers of a lawyer-controlled body who are named trustees, in respect of practice outside the UK; and~~

~~regulating: the accounts of solicitors and registered European lawyers, lawyer-controlled and registered European lawyer-controlled bodies and their managers, lawyer of England and Wales and registered European lawyer managers of overseas law firms controlled by lawyers of England and Wales and/or registered European lawyers, solicitors and registered European lawyers who are named trustees, and managers of a lawyer-controlled body or a registered European lawyer-controlled body who are named trustees, in respect of practice from Scotland or Northern Ireland.~~

For the definition of words in italics ~~in Parts 1-6,~~ see rule 2 - Interpretation. ~~For the definition of words in italics in Part 7 see rule 48 – Application and Interpretation (overseas provisions).~~

Introduction

The Principles set out in the Handbook apply to all aspects of practice, including the handling of client money. Those which are particularly relevant to these rules are that you must:

- protect client money and assets;
- act with integrity;
- behave in a way that maintains the trust the public places in you and in the provision of legal services;

- comply with your legal and regulatory obligations and deal with your regulators and ombudsmen in an open, timely and co-operative manner; and
- run your business or carry out your role in the business effectively and in accordance with proper governance and sound financial and risk management principles.

The desired outcomes which apply to these rules are that:

- client money is safe;
- clients and the public have confidence that client money held by firms will be safe;
- firms are managed in such a way, and with appropriate systems and procedures in place, so as to safeguard client money;
- client accounts are used for appropriate purposes only; and
- the SRA is aware of issues in a firm relevant to the protection of client money.

Underlying principles which are specific to the accounts rules are set out in rule 1 below.

These rules apply to all those who carry on or work in a firm and to the firm itself (see rules 4 and 5). In relation to a multi-disciplinary practice, the rules apply only in respect of those activities for which the practice is regulated by the SRA, and are concerned only with money handled by the practice which relates to those regulated activities.

Part 1: General

Rule 1: The overarching objective and underlying principles

1.1 The purpose of these rules is to keep *client money* safe. This aim must always be borne in mind in the application of these rules.

1.2 *You* must comply with the Principles set out in the Handbook, and the outcomes in Chapter 7 of the *SRA Code of Conduct* in relation to the effective financial management of the *firm*, and in particular must:

(a) keep other people's money separate from money belonging to *you* or *your firm*;

(b) keep other people's money safely in a *bank* or *building society* account identifiable as a *client account* (except when the rules specifically provide otherwise);

(c) use each *client's* money for that *client's* matters only;

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

(e) establish and maintain proper accounting systems, and proper internal controls over those systems, to ensure compliance with the rules;

(f) keep proper accounting records to show accurately the position with regard to the money held for each *client* and *trust*;

(g) account for *interest* on other people's money in accordance with the rules;

(h) co-operate with the *SRA* in checking compliance with the rules; and

(i) deliver annual accountant's reports as required by the rules.

Rule 2: Interpretation

2.1 The guidance notes do not form part of the rules.

2.2 The SRA Handbook Glossary 2012 shall apply and, unless the context otherwise requires:

(a) all italicised terms shall be defined; and

(b) all terms shall be interpreted,

in accordance with the *Glossary*.

2.3 References to the Legal Aid Agency are to be read, where appropriate, as including the Legal Services Commission.

Guidance notes

(i) The effect of the definition of "you" is that the rules apply equally to all those who carry on or work in a firm and to the firm itself. See also rule 4 (persons governed by the rules) and rule 5 (persons exempt from the rules).

(ii) The general definition of "office account" is wide. However, rule 17.1(b) (receipt and transfer of costs) and rule 19.1(b) and 19.2(b) (payments from the Legal Aid Agency) specify that certain money is to be placed in an office account at a bank or building society. Out-of-scope money can be held in an office account (which could be an account regulated by another regulator); it must not be held in a client account.

(iii) For a flowchart summarising the effect of the rules, see Appendix 1. For more details of the treatment of different types of money, see the chart "Special situations - what applies" at Appendix 2. These two appendices do not form part of the rules but are included to help solicitors and their staff find their way about the rules.

Rule 3: Geographical scope

3.1 Parts 1 to 6 of these rules apply to practice carried on from an office in England and Wales. Part 7 of these rules applies to ~~practice carried on from an office outside England and Wales and~~ the practice of an *REL* from an office in England and Wales of an *Exempt European Practice*.

Rule 4: Persons governed by the rules

4.1 Save as provided in rule 4.2 below, Parts 1 to 6 of these rules apply to ***you***.

4.2 In relation to an ***MDP***, the rules apply to ***you*** only in respect of your ***regulated activities***.

4.3 Part 6 of the rules (accountants' reports) also applies to reporting accountants.

4.4 If ***you*** have held or received ***client money***, but no longer do so, whether or not ***you*** continue in practice, ***you*** continue to be bound by some of the rules.

Guidance notes

(i) "You" is defined in the Glossary. All employees of a recognised body or licensed body are directly subject to the rules, following changes made by the Legal Services Act 2007. All employees of a recognised sole practitioner are also directly subject to the rules under sections 1B and 34A of the Solicitors Act 1974. Non-compliance by any member of staff will also lead to the principals being in breach of the rules - see rule 6. Misconduct by an employee can also lead to an order of the SRA or the Solicitors Disciplinary Tribunal under section 43 of the Solicitors Act 1974 imposing restrictions on his or her employment.

(ii) Rules which continue to apply to you where you no longer hold client money include:

(a) rule 7 (duty to remedy breaches);

(b) rule 17.2 and 17.8, rule 29.15 to 29.24 and rule 30 (retention of records);

(c) rule 31 (production of documents, information and explanations);

(d) Part 6 (accountants' reports), and in particular rule 32 and rule 33.5 (delivery of final report)~~,~~ and rule 35.2~~ and rule 43 (completion of checklist).~~

(iii) The rules do not cover trusteeships carried on in a purely personal capacity outside any legal practice. It will normally be clear from the terms of the appointment whether you are being appointed in a purely personal capacity or in your professional capacity. If you are charging for the work, it is clearly being done in a professional capacity. Use of professional stationery may also indicate that the work is being done in a professional capacity.

(iv) A solicitor who wishes to retire from private practice will need to make a decision about any professional trusteeship. There are three possibilities:

(a) continue to act as a professional trustee (as evidenced by, for instance, charging for work done, or by continuing to use the title "solicitor" in connection with the trust). In this case, the solicitor must continue to hold a practising certificate, and money subject to the trust must continue to be dealt with in accordance with the rules.

(b) continue to act as trustee, but in a purely personal capacity. In this case, the solicitor must stop charging for the work, and must not be held out as a solicitor (unless this is qualified by words such as "non-practising" or "retired") in connection with the trust.

(c) cease to be a trustee.

(v) A licensed body may undertake a range of services, comprising both "traditional" legal services and other, related, services of a non-legal nature, for example, where a solicitor, estate agent and surveyor set up in practice together. Where a licensed body practises in this way (an MDP), only some of the services it provides (reserved and other legal activities, and other activities which are subject to one or more conditions on the body's licence) are within the regulatory reach of the SRA. Other, "non-legal", activities of the licensed body may be regulated by another regulator, and some activities may not fall within the regulatory ambit of any regulator.

Rule 5: Persons exempt from the rules

5.1 The rules do not apply to *you* when:

(a) practising as an employee of:

(i) a *local authority*;

(ii) *statutory undertakers*;

(iii) a body whose accounts are audited by the Comptroller and Auditor General;

(iv) the Duchy of Lancaster;

(v) the Duchy of Cornwall; or

(vi) the Church Commissioners; or

(b) practising as the Solicitor of the City of London; or

(c) carrying out the functions of:

(i) a coroner or other judicial office; or

(ii) a sheriff or under-sheriff; or

(d) practising as a *manager* or employee of an *authorised non-SRA firm*, and acting within the scope of that *firm's* authorisation to practise.

Guidance note

(i) A person practising as a manager or employee of an authorised non-SRA firm is exempt from the Accounts Rules when acting within the scope of the firm's authorisation. Thus if a solicitor is a partner or employee in a firm authorised by the Council for Licensed Conveyancers, the rules will not apply to any money received by the solicitor in connection with conveyancing work. However if the solicitor does in-house litigation work - say collecting money owed to the firm - the Accounts Rules will apply to any money received by the solicitor in that context. This is because, whilst in-house litigation work is within the scope of the solicitor's authorisation as an individual, it is outside the scope of authorisation of the firm.

Rule 6: Principals' responsibility for compliance

6.1 All the *principals* in a *firm* must ensure compliance with the rules by the *principals* themselves and by everyone employed in the *firm*. This duty also extends to the *directors* of a *recognised body* or *licensed body* which is a *company*, or to the members of a *recognised body* or *licensed body* which is an *LLP*. It also extends to the *COFA* of a *firm* (whether a *manager* or non-*manager*).

Guidance note

(i) Rule 8.5(d) of the SRA Authorisation Rules requires all firms to have a COFA. The appointment of a COFA satisfies the requirement under section 92 of the Legal Services Act 2007 for a licensed body to appoint a Head of Finance and Administration. Under rule 6 of the accounts rules, the COFA must ensure compliance with the accounts rules. This obligation is in addition to, not instead of, the duty of all the principals to ensure compliance (the COFA may be subject to this duty both as COFA and as a principal). Under rule 8.5(e) of the SRA Authorisation Rules, the COFA of a licensed body must report any breaches, and the COFA of a recognised body must report material breaches, of the accounts rules to the SRA as soon as reasonably practicable. The COFA of a recognised sole practitioner has a duty to report material breaches under regulation 4.8(e) of the SRA Practising Regulations. All COFAs must record any breaches and make those records available to the SRA on request. (See also outcomes 10.3 and 10.4 of Chapter 10 of the SRA Code of Conduct in relation to the general duty to report serious financial difficulty or serious misconduct.)

Rule 7: Duty to remedy breaches

7.1 Any breach of the rules must be remedied promptly upon discovery. This includes the replacement of any money improperly withheld or withdrawn from a *client account*.

7.2 In a private practice, the duty to remedy breaches rests not only on the person causing the breach, but also on all the *principals* in the *firm*. This duty extends to replacing missing *client money* from the *principals'* own resources, even if the money has been misappropriated by an employee or another *principal*, and whether or not a claim is subsequently made on the *firm's* insurance or the Compensation Fund.

Rule 8: Liquidators, trustees in bankruptcy, Court of Protection deputies and trustees of occupational pension schemes

8.1 If in the course of practice *you* act as:

(a) a liquidator,

(b) a trustee in bankruptcy,

(c) a *Court of Protection deputy*, or

(d) a trustee of an occupational pension scheme which is subject to section 47(1)(a) of the Pensions Act 1995 (appointment of an auditor) and section 49(1) (separate bank account) and regulations under section 49(2)(b) (books and records),

you must comply with:

(i) the appropriate statutory rules or regulations;

(ii) the Principles referred to, and the underlying principles set out, in rule 1; and

(iii) the requirements of rule 8.2 to 8.4 below;

and will then be deemed to have satisfactorily complied with the Accounts Rules.

8.2 In respect of any records kept under the appropriate statutory rules, there must also be compliance with:

(a) rule 29.15 - bills and notifications of costs;

(b) rule 29.17(c) - retention of records;

(c) rule 29.20 - centrally kept records;

(d) rule 31 - production of documents, information and explanations; and

(e) rule 3~~8~~9.1~~(l) and (p)~~ - reporting accountant to check compliance.

8.3 If a liquidator or trustee in bankruptcy uses any of the *firm's client accounts* for holding money pending transfer to the Insolvency Services Account or to a local bank account authorised by the Secretary of State, he or she must comply with the Accounts Rules in all respects whilst the money is held in the *client account*.

8.4 If the appropriate statutory rules or regulations do not govern the holding or receipt of *client money* in a particular situation (for example, money below a certain limit), *you* must comply with the Accounts Rules in all respects in relation to that money.

Guidance notes

(i) The Insolvency Regulations 1994 (S.I. 1994 no. 2507) regulate liquidators and trustees in bankruptcy.

(ii) The Court of Protection Rules 2007 (S.I. 2007 no. 1744 (L.12)) regulate Court of Protection deputies.

(iii) Money held or received by liquidators, trustees in bankruptcy, Court of Protection deputies and trustees of occupational pension schemes is client money but, because of the statutory rules and rule 8.1, it will not normally be kept in a client account. If for any reason it is held in a client account, the Accounts Rules apply to that money for the time it is so held (see rule 8.3 and 8.4).

Rule 9: Joint accounts

9.1 If, when acting in a *client's* matter, *you* hold or receive money jointly with the *client*, another practice or another third party, the rules in general do not apply, but the following must be complied with:

(a) rule 29.11 - statements from banks, building societies and other financial institutions;

(b) rule 29.15 - bills and notifications of costs;

(c) rule 29.17(b)(ii) - retention of statements and passbooks;

(d) rule 29.21 - centrally kept records;

(e) rule 31 - production of documents, information and explanations; and

(f) rule 38.1 ~~39.1(m) and (p)~~ - reporting accountant to check compliance.

A joint account is not a *client account* but money held in a joint account is *client money*.

Operation of the joint account by you only

9.2 If the joint account is operated only by *you*, *you* must ensure that *you* receive the statements from the *bank*, *building society* or other financial institution in accordance with rule 29.11, and have possession of any passbooks.

Shared operation of the joint account

9.3 If *you* share the operation of the joint account with the *client*, another practice or another third party, *you* must:

(a) ensure that *you* receive the statements or duplicate statements from the *bank*, *building society* or other financial institution in accordance with rule 29.11, and retain them in accordance with rule 29.17(b)(ii); and

(b) ensure that *you* either have possession of any passbooks, or take copies of the passbook entries before handing any passbook to the other signatory, and retain them in accordance with rule 29.17(b)(ii).

Operation of the joint account by the other account holder

9.4 If the joint account is operated solely by the other account holder, *you* must ensure that *you* receive the statements or duplicate statements from the *bank*, *building society* or other financial institution in accordance with rule 29.11, and retain them in accordance with rule 29.17(b)(ii).

Rule 10: Operation of a client's own account

10.1 If, in the course of practice, *you* operate a *client's* own account as signatory (for example, as donee under a power of attorney), the rules in general do not apply, but the following must be complied with:

(a) rule 30.1 to 30.4 - accounting records for clients' own accounts;

(b) rule 31 - production of documents, information and explanations; and

(c) rule 38.1~~39.1(n) and (p)~~ - reporting accountant to check compliance.

Operation by you only

10.2 If the account is operated by *you* only, *you* must ensure that *you* receive the statements from the *bank*, *building society* or other financial institution in accordance with rule 30, and have possession of any passbooks.

Shared operation of the account

10.3 If *you* share the operation of the account with the *client* or a co-attorney outside *your firm*, *you* must:

(a) ensure that *you* receive the statements or duplicate statements from the *bank*, *building society* or other financial institution and retain them in accordance with rule 30.1 to 30.4; and

(b) ensure that *you* either have possession of any passbooks, or take copies of the passbook entries before handing any passbook to the *client* or co-attorney, and retain them in accordance with rule 30.1 to 30.4.

Operation of the account for a limited purpose

10.4 If *you* are given authority (whether as attorney or otherwise) to operate the account for a limited purpose only, such as the taking up of a share rights issue during the

client's temporary absence, *you* need not receive statements or possess passbooks, provided that *you* retain details of all cheques drawn or paid in, and retain copies of all passbook entries, relating to the transaction, and retain them in accordance with rule 30.1 to 30.3.

Application

10.5 This rule applies only to private practice. It does not cover money held or received by a donee of a power of attorney acting in a purely personal capacity outside any legal practice (see rule 4, guidance notes (iii)-(iv)).

10.6 A "*client's* own account" covers all accounts in a *client's* own name, whether opened by the *client* himself or herself, or by *you* on the *client's* instructions under rule 15.1(b). A "*client's* own account" also includes an account opened in the name of a person designated by the *client* under rule 15.1(b).

Guidance notes

(i) Money held in a client's own account (under a power of attorney or otherwise) is not "client money" for the purpose of the rules because it is not "held or received" by you. If you close the account and receive the closing balance, this becomes client money subject to all the rules.

(ii) Merely paying money into a client's own account, or helping the client to complete forms in relation to such an account, is not "operating" the account.

(iii) If as executor you operate the deceased's account (whether before or after the grant of probate), you will be subject to the limited requirements of rule 10. If the account is subsequently transferred into your name, or a new account is opened in your name, you will have "held or received" client money and are then subject to all the rules.

Rule 11: Firm's rights not affected

11.1 Nothing in these rules deprives *you* of any recourse or right, whether by way of lien, set off, counterclaim, charge or otherwise, against money standing to the credit of a *client account*.

Rule 12: Categories of money

12.1 These rules do not apply to *out-of-scope money*, save to the limited extent specified in the rules. All other money held or received in the course of practice falls into one or other of the following categories:

(a) "client money" - money held or received for a *client* or as *trustee*, and all other money which is not *office money*; or

(b) "office money" - money which belongs to *you* or *your firm*.

12.2 "Client money" 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 stamp duty land tax, Land Registry registration fees, telegraphic transfer fees and court fees (but see also guidance note (i));

(e) as a payment on account of *costs* generally;

(f) as a financial benefit paid in respect of a *client*, unless the *client* has given *you* prior authority to retain it (see Chapter 1, outcome 1.15 and indicative behaviour 1.20 of the *SRA Code of Conduct*);

(g) jointly with another person outside the *firm*.

12.3 Money held to the sender's order is *client money*.

(a) If money is accepted on such terms, it must be held in a *client account*.

(b) However, a cheque or draft sent to *you* on terms that the cheque or draft (as opposed to the money) is held to the sender's order must not be presented for payment without the sender's consent.

(c) The recipient is always subject to a professional obligation to return the money, or the cheque or draft, to the sender on demand.

12.4 An advance to a *client* which is paid into a *client account* under rule 14.2(b) becomes *client money*.

12.5 A cheque in respect of damages and *costs*, made payable to the *client* but paid into a *client account* under rule 14.2(e), becomes *client money*.

12.6 Endorsing a cheque or draft over to a *client* or employer in the course of practice amounts to receiving *client money*. Even if no other *client money* is held or received, *you* must comply with some provisions of the rules, e.g.:

(a) rule 7 (duty to remedy breaches);

(b) rule 29 (accounting records for client accounts, etc.);

(c) rule 31 (production of documents, information and explanations);

(d) rule 32 (obtaining and delivery of accountants' reports).

12.7 "Office money" includes:

(a) money held or received in connection with running the *firm*; for example, PAYE, or VAT on the *firm's fees*;

(b) *interest* on *general client accounts*; the *bank* or *building society* should be instructed to credit such *interest* to the *office account* - but see also rule 14.2(d);

(c) payments received in respect of:

(i) *fees* due to the *firm* against a bill or written notification of *costs* incurred, which has been given or sent in accordance with rule 17.2;

(ii) *disbursements* already paid by the *firm*;

(iii) *disbursements* incurred but not yet paid by the *firm*, but excluding unpaid *professional disbursements*;

(iv) money paid for or towards an *agreed fee*;

(d) money held in a *client account* and earmarked for *costs* under rule 17.3;

(e) money held or received from the Legal Aid Agency as a *regular payment* (see rule 19.2).

12.8 If a *firm* conducts a personal or office transaction - for instance, conveyancing - for a *principal* (or for a number of *principals*), money held or received on behalf of the *principal(s)* is *office money*. However, other circumstances may mean that the money is *client money*, for example:

(a) If the *firm* also acts for a lender, money held or received on behalf of the lender is *client money*.

(b) If the *firm* acts for a *principal* and, for example, his or her spouse jointly (assuming the spouse is not a *partner* in the practice), money received on their joint behalf is *client money*.

(c) If the *firm* acts for an assistant *solicitor*, consultant or non-solicitor employee, or (if it is a *company*) a *director*, or (if it is an *LLP*) a member, he or she is regarded as a *client* of the *firm*, and money received for him or her is *client money* - even if he or she conducts the matter personally.

Guidance notes

(i) Money held or received for payment of stamp duty land tax, Land Registry registration fees, telegraphic transfer fees and court fees is not office money because you have not incurred an obligation to HMRC, the Land Registry, the bank or the court to pay the duty or fee; (on the other hand, if you have already paid the duty or fee out of your own resources, or have received the service on credit, or the bank's charge for a telegraphic transfer forms part of your profit costs, payment subsequently received from the client will be office money);

(ii) Money held:

(a) by liquidators, trustees in bankruptcy, Court of Protection deputies and trustees of occupational pension schemes;

(b) jointly with another person outside the practice (for example, with a lay trustee, or with another firm);

is client money, subject to a limited application of the rules - see rules 8 and 9. The donee of a power of attorney, who operates the donor's own account, is also subject to a limited application of the rules (see rule 10), although money kept in the donor's own account is not "client money" because it is not "held or received" by the donee.

(iii) If the SRA intervenes in a practice, money from the practice is held or received by the SRA's intervention agent subject to a trust under Schedule 1 paragraph 7(1) of the Solicitors Act 1974, and is therefore client money. The same provision requires the agent to pay the money into a client account.

(iv) Money held or received in the course of employment when practising in one of the capacities listed in rule 5 (persons exempt from the rules) is not "client money" for the purpose of the rules, because the rules do not apply at all.

(v) The receipt of out-of-scope money of an MDP which is mixed with other types of money is dealt with in rules 17 and 18.

(vi) See Appendices 1 and 2 (which do not form part of the rules) for a summary of the effect of the rules and the treatment of different types of money.

Part 2: Client money and operation of a client account

Rule 13: Client accounts

13.1 If ***you*** hold or receive ***client money***, ***you*** must keep one or more ***client accounts*** (unless all the ***client money*** is always dealt with outside any ***client account*** in accordance with rule 8, rule 9, rule 15 or rule 16).

13.2 A "client account" is an account of a practice kept at a ***bank*** or ***building society*** for holding ***client money***, in accordance with the requirements of this part of the rules.

13.3 The ***client account(s)*** of:

(a) a ***sole practitioner*** must be in the name under which the ***sole practitioner*** is recognised by the ***SRA***, whether that is the ***sole practitioner's*** own name or the ***firm*** name;

(b) a ***partnership*** must be in the name under which the ***partnership*** is recognised by the ***SRA***;

(c) an incorporated practice must be in the company name, or the name of the *LLP*, as registered at Companies House;

(d) in-house *solicitors* or *RELs* must be in the name of the current *principal solicitor*/*REL* or *solicitors*/*RELs*;

(e) *trustees*, where all the *trustees* of a *trust* are *managers* and/or employees of the same *recognised body* or *licensed body*, must be either in the name of the *recognised body*/*licensed body* or in the name of the *trustee(s)*;

(f) *trustees*, where all the *trustees* of a *trust* are the *sole practitioner* and/or his or her employees, must be either in the name under which the *sole practitioner* is recognised by the *SRA* or in the name of the *trustee(s)*;

and the name of the account must also include the word "client" in full (an abbreviation is not acceptable).

13.4 A *client account* must be:

(a) a *bank* account at a branch (or a *bank's* head office) in England and Wales; or

(b) a *building society* account at a branch (or a society's head office) in England and Wales.

13.5 There are two types of *client account*:

(a) a "separate designated client account", which is an account for money relating to a single *client*, other person or *trust*, and which includes in its title, in addition to the requirements of rule 13.3 above, a reference to the identity of the *client*, other person or *trust*; and

(b) a "general client account", which is any other *client account*.

13.6 [Deleted]

13.7 The *clients* of a *licensed body* must be informed at the outset of the retainer, or during the course of the retainer as appropriate, if the *licensed body* is (or becomes) owned by a *bank* or *building society* and its *client account* is held at that *bank* or *building society* (or another *bank* or *building society* in the same group).

13.8 Money held in a *client account* must be immediately available, even at the sacrifice of *interest*, unless the *client* otherwise instructs, or the circumstances clearly indicate otherwise.

Guidance notes

~~(i)~~ In the case of in-house practice, any client account should include the names of all solicitors or registered European lawyers held out

on the notepaper as principals. The names of other employees who are solicitors or registered European lawyers may also be included if so desired. ~~Any person whose name is included will have to be included on the accountant's report.~~

(i) A firm may have any number of separate designated client accounts and general client accounts.

(ii) Compliance with rule 13.1 to 13.4 ensures that clients, as well as the bank or building society, have the protection afforded by section 85 of the Solicitors Act 1974 or article 4 of the Legal Services Act 2007 (Designation as a Licensing Authority) (No. 2) Order 2011 as appropriate.

Rule 14: Use of a client account

14.1 *Client money* must *without delay* be paid into a *client account*, and must be held in a *client account*, except when the rules provide to the contrary (see rules 8, 9, 15, 16, 17 and 19).

14.2 Only *client money* may be paid into or held in a *client account*, except:

(a) an amount of the *firm's* own money required to open or maintain the account;

(b) an advance from the *firm* to fund a payment on behalf of a *client* or *trust* in excess of funds held for that *client* or *trust*; the sum becomes *client money* on payment into the account (for *interest* on *client money*, see rule 22.2(c));

(c) money to replace any sum which for any reason has been drawn from the account in breach of rule 20; the replacement money becomes *client money* on payment into the account;

(d) *interest* which is paid into a *client account* to enable payment from the *client account* of all money owed to the *client*; and

(e) a cheque in respect of damages and *costs*, made payable to the *client*, which is paid into the *client account* pursuant to the *Society's* Conditional Fee Agreement; the sum becomes *client money* on payment into the account (but see rule 17.1(e) for the transfer of the *costs* element from *client account*);

and except when the rules provide to the contrary (see guidance note (ii) below).

14.3 *Client money* must be returned to the *client* (or other person on whose behalf the money is held) promptly, as soon as there is no longer any proper reason to retain those funds. Payments received after *you* have already accounted to the *client*, for example by way of a refund, must be paid to the *client* promptly.

14.4 *You* must promptly inform a *client* (or other person on whose behalf the money is held) in writing of the amount of any *client money* retained at the end of a matter

(or the substantial conclusion of a matter), and the reason for that retention. ***You*** must inform the ***client*** (or other person) in writing at least once every twelve months thereafter of the amount of ***client money*** still held and the reason for the retention, for as long as ***you*** continue to hold that money.

14.5 ***You*** must not provide banking facilities through a ***client account***. Payments into, and transfers or withdrawals from, a ***client account*** must be in respect of instructions relating to an underlying transaction (and the funds arising therefrom) or to a service forming part of ***your*** normal regulated activities.

Guidance notes

(i) Exceptions to rule 14.1 (client money must be paid into a client account) can be found in:

(a) rule 8 - liquidators, trustees in bankruptcy, Court of Protection deputies and trustees of occupational pension schemes;

(b) rule 9 - joint accounts;

(c) rule 15 - client's instructions;

(d) rule 16 - cash paid straight to client, beneficiary or third party;

(A) cheque endorsed to client, beneficiary or third party;

(B) money withheld from client account on the SRA's authority;

(C) money withheld from client account in accordance with a trustee's powers;

(e) rule 17.1(b) - receipt and transfer of costs;

(f) rule 19.1 - payments by the Legal Aid Agency.

(ii) Rule 14.2(a) to (e) provides for exceptions to the principle that only client money may be paid into a client account. Additional exceptions can be found in:

(a) rule 17.1(c) - receipt and transfer of costs;

(b) rule 18.2(b) - receipt of mixed payments;

(c) rule 19.2(c)(ii) - transfer to client account of a sum for unpaid professional disbursements, where regular payments are received from the Legal Aid Agency.

(iii) Only a nominal sum will be required to open or maintain an account. In practice, banks will usually open (and, if instructed, keep open) accounts with nil balances.

(iv) If client money is invested in the purchase of assets other than money - such as stocks or shares - it ceases to be client money, because it is no longer money held by the firm. If the investment is subsequently sold, the money received is, again, client money. The records kept under rule 29 will need to include entries to show the purchase or sale of investments.

(v) Rule 14.5 reflects decisions of the Solicitors Disciplinary Tribunal that it is not a proper part of a solicitor's everyday business or practice to operate a banking facility for third parties, whether they are clients of the firm or not. It should be noted that any exemption under the Financial Services and Markets Act 2000 is likely to be lost if a deposit is taken in circumstances which do not form part of your practice. It should also be borne in mind that there are criminal sanctions against assisting money launderers.

(vi) As with rule 7 (Duty to remedy breaches), "promptly" in rule 14.3 and 14.4 is not defined but should be given its natural meaning in the particular circumstances. Accounting to a client for any surplus funds will often fall naturally at the end of a matter. Other retainers may be more protracted and, even when the principal work has been completed, funds may still be needed, for example, to cover outstanding work in a conveyancing transaction or to meet a tax liability. (See also paragraphs 4.8 and 4.9 of the Guidelines for accounting procedures and systems at Appendix 3.)

(vii) There may be some instances when, during the course of a retainer, the specific purpose for which particular funds were paid no longer exists, for example, the need to instruct counsel or a medical expert. Rule 14.3 is concerned with returning funds to clients at the end of a matter (or the substantial conclusion of a matter) and is not intended to apply to ongoing retainers. However, in order to act in the best interests of your client, you may need to take instructions in such circumstances to ascertain, for instance, whether the money should be returned to the client or retained to cover the general funding or other aspects of the case.

(viii) See rule 20.1(j)-(k) for withdrawals from a client account when the rightful owner of funds cannot be traced. The obligation to report regularly under rule 14.4 ceases to apply if you are no longer able to trace the client, at which point rule 20.1(j) or (k) would apply.

Rule 15: Client money withheld from client account on client's instructions

15.1 *Client money* may be:

(a) held by *you* outside a *client account* by, for example, retaining it in the *firm's* safe in the form of cash, or placing it in an account in the *firm's* name which is not a *client account*, such as an account outside England and Wales; or

(b) paid into an account at a *bank*, *building society* or other financial institution opened in the name of the *client* or of a person designated by the *client*;

but only if the *client* instructs *you* to that effect for the *client's* own convenience, and only if the instructions are given in writing, or are given by other means and confirmed by *you* to the *client* in writing.

15.2 It is improper to seek blanket agreements, through standard terms of business or otherwise, to hold *client money* outside a *client account*.

15.3 If a *client* instructs *you* to hold part only of a payment in accordance with rule 15.1(a) or (b), the entire payment must first be placed in a *client account*, before transferring the relevant part out and dealing with it in accordance with the *client's* instructions.

15.4 A payment on account of *costs* received from a person who is funding all or part of *your fees* may be withheld from a *client account* on the instructions of that person given in accordance with rule 15.1.

Guidance notes

(i) Money withheld from a client account under rule 15.1(a) remains client money, and all the record-keeping provisions of rule 29 will apply.

(ii) Once money has been paid into an account set up under rule 15.1(b), it ceases to be client money. Until that time, the money is client money and, under rule 29, a record is required of your receipt of the money, and its payment into the account in the name of the client or designated person. If you can operate the account, rule 10 (operating a client's own account) and rule 30 (accounting records for clients' own accounts) will apply. In the absence of instructions to the contrary, rule 14.1 requires any money withdrawn to be paid into a client account.

(iii) Rule 29.17(d) requires clients' instructions under rule 15.1 to be kept for at least six years.

Rule 16: Other client money withheld from a client account

16.1 The following categories of *client money* may be withheld from a *client account*:

(a) cash received and *without delay* paid in cash in the ordinary course of business to the *client* or, on the *client's* behalf, to a third party, or paid in cash in the execution of a *trust* to a beneficiary or third party;

(b) a cheque or draft received and endorsed over in the ordinary course of business to the *client* or, on the *client's* behalf, to a third party, or *without delay* endorsed over in the execution of a *trust* to a beneficiary or third party;

(c) money withheld from a *client account* on instructions under rule 15;

(d) money which, in accordance with a *trustee's* powers, is paid into or retained in an account of the *trustee* which is not a *client account* (for example, an account outside England and Wales), or properly retained in cash in the performance of the *trustee's* duties;

(e) unpaid *professional disbursements* included in a payment of *costs* dealt with under rule 17.1(b);

(f) in respect of payments from the Legal Aid Agency:

(i) advance payments from the Legal Aid Agency withheld from *client account* (see rule 19.1(a)); and

(ii) unpaid *professional disbursements* included in a payment of *costs* from the Legal Aid Agency (see rule 19.1(b)); and

(g) money withheld from a *client account* on the written authorisation of the *SRA*. The *SRA* may impose a condition that the money is paid to a charity which gives an indemnity against any legitimate claim subsequently made for the sum received.

Guidance notes

(i) If money is withheld from a client account under rule 16.1(a) or (b), rule 29 requires records to be kept of the receipt of the money and the payment out.

(ii) If money is withheld from a client account under rule 16.1(d), rule 29 requires a record to be kept of the receipt of the money, and requires the inclusion of the money in the monthly reconciliations. (Money held by a trustee jointly with another party is subject only to the limited requirements of rule 9.)

(iii) It makes no difference, for the purpose of the rules, whether an endorsement is effected by signature in the normal way or by some other arrangement with the bank.

(iv) The circumstances in which authorisation would be given under rule 16.1(g) must be extremely rare. Applications for authorisation should be made to the Professional Ethics Guidance Team.

Rule 17: Receipt and transfer of costs

17.1 When *you* receive money paid in full or part settlement of *your* bill (or other notification of *costs*) *you* **must follow one of the following five options**:

(a) **determine the composition of the payment without delay, and deal with the money accordingly:**

(i) if the sum comprises *office money* and/or *out-of-scope money* only, it must be placed in an *office account*;

(ii) if the sum comprises only *client money*, the entire sum must be placed in a *client account*;

(iii) if the sum includes both *office money* and *client money*, or *client money* and *out-of-scope money*, or *client money*, *out-of-scope money* and *office money*, *you* must follow rule 18 (receipt of mixed payments); or

(b) **ascertain that the payment comprises only *office money* and/or *out-of-scope money*, and/or *client money* in the form of *professional disbursements* incurred but not yet paid, and deal with the payment as follows:**

(i) place the entire sum in an *office account* at a *bank* or *building society* branch (or head office) in England and Wales; and

(ii) by the end of the second working day following receipt, either pay any unpaid *professional disbursement*, or transfer a sum for its settlement to a *client account*; or

(c) **pay the entire sum into a *client account* (regardless of its composition), and transfer any *office money* and/or *out-of-scope money* out of the *client account* within 14 days of receipt; or**

(d) **on receipt of *costs* from the Legal Aid Agency, follow the option in rule 19.1(b); or**

(e) **in relation to a cheque paid into a *client account* under rule 14.2(e), transfer the *costs* element out of the *client account* within 14 days of receipt.**

17.2 If *you* properly require payment of *your fees* from money held for a *client* or *trust* in a *client account*, *you* must first give or send a bill of *costs*, or other written notification of the *costs* incurred, to the *client* or the paying party.

17.3 Once *you* have complied with rule 17.2 above, the money earmarked for *costs* becomes *office money* and must be transferred out of the *client account* within 14 days.

17.4 A payment on account of *costs* generally in respect of those activities for which the practice is regulated by the *SRA* is *client money*, and must be held in a *client account* until *you* have complied with rule 17.2 above. (For an exception in the case of legal aid payments, see rule 19.1(a). See also rule 18 on dealing with mixed payments of *client money* and/or *out-of-scope money* when part of a payment on account of *costs* relates to activities not regulated by the *SRA*.)

17.5 A payment for an *agreed fee* must be paid into an *office account*. An "agreed fee" is one that is fixed - not a *fee* that can be varied upwards, nor a *fee* that is dependent on the transaction being completed. An *agreed fee* must be evidenced in writing.

17.6 *You* will not be in breach of rule 17 as a result of a misdirected electronic payment or other direct transfer from a *client* or paying third party, provided:

(a) appropriate systems are in place to ensure compliance;

(b) appropriate instructions were given to the *client* or paying third party;

(c) the *client's* or paying third party's mistake is remedied promptly upon discovery; and

(d) appropriate steps are taken to avoid future errors by the *client* or paying third party.

17.7 *Costs* transferred out of a *client account* in accordance with rule 17.2 and 17.3 must be specific sums relating to the bill or other written notification of *costs*, and covered by the amount held for the particular *client* or *trust*. Round sum withdrawals on account of *costs* are a breach of the rules.

17.8 In the case of a *trust* of which the only *trustee(s)* are within the *firm*, the paying party will be the *trustee(s)* themselves. *You* must keep the original bill or notification of *costs* on the file, in addition to complying with rule 29.15 (central record or file of copy bills, etc.).

17.9 Undrawn *costs* must not remain in a *client account* as a "cushion" against any future errors which could result in a shortage on that account, and cannot be regarded as available to set off against any general shortage on *client account*.

Guidance notes

(i) This note lists types of disbursement and how they are categorised:

(a) Money received for paid disbursements is office money.

(b) Money received for unpaid professional disbursements is client money.

(c) Money received for other unpaid disbursements for which you have incurred a liability to the payee (for example, travel agents' charges, taxi fares, courier charges or Land Registry search fees, payable on credit) is office money.

(d) Money received for disbursements anticipated but not yet incurred is a payment on account, and is therefore client money.

(ii) The option in rule 17.1(a) allows you to place all payments in the correct account in the first instance. The option in rule 17.1(b) allows the prompt banking into an office account of an invoice payment when the only uncertainty is whether or not the payment includes some client money in the form of unpaid professional disbursements. The option in rule 17.1(c) allows the prompt banking into a client account of any invoice payment in advance of determining whether the payment is a mixture of office and client money (of whatever description), or client money and out-of-scope money, or client money, out-of-scope money and office money, or is only office money and/or out-of-scope money.

(iii) If you are not in a position to comply with the requirements of rule 17.1(b), you cannot take advantage of that option.

(iv) The option in rule 17.1(b) cannot be used if the money received includes a payment on account - for example, a payment for a professional disbursement anticipated but not yet incurred.

(v) In order to be able to use the option in rule 17.1(b) for electronic payments or other direct transfers from clients, you may choose to establish a system whereby clients are given an office account number for payment of costs. The system must be capable of ensuring that, when invoices are sent to the client, no request is made for any client money, with the sole exception of money for professional disbursements already incurred but not yet paid.

(vi) Rule 17.1(c) allows clients to be given a single account number for making direct payments by electronic or other means - under this option, it has to be a client account.

(vii) "Properly" in rule 17.2 implies that the work has actually been done, whether at the end of the matter or at an interim stage, and that you are entitled to appropriate the money for costs. For example, the costs set out in a completion statement in a conveyancing transaction will become due on completion and should be transferred out of the client account within 14 days of completion in accordance with rule 17.3. The requirement to transfer costs out of the client account within a set time is intended to prevent costs being left on client account to conceal a shortage.

(viii) Money is "earmarked" for costs under rule 17.2 and 17.3 when you decide to use funds already held in client account to settle your bill. If you wish to obtain the client's prior approval, you will need to agree the amount to be taken with your client before issuing the bill to avoid the possibility of failing to meet the 14 day time limit for making the transfer out of client account. If you wish to retain the funds, for example, as money on account of costs on another matter, you will need to ask the client to send the full amount in

settlement of the bill. If, when submitting a bill, you fail to indicate whether you intend to take your costs from client account, or expect the client to make a payment, you will be regarded as having "earmarked" your costs.

(ix) An amendment to section 69 of the Solicitors Act 1974 by the Legal Services Act 2007 permits a solicitor or recognised body to sue on a bill which has been signed electronically and which the client has agreed can be delivered electronically.

(x) The rules do not require a bill of costs for an agreed fee, although your VAT position may mean that in practice a bill is needed. If there is no bill, the written evidence of the agreement must be filed as a written notification of costs under rule 29.15(b).

(xi) The bill of an MDP may be in respect of costs for work of the SRA-regulated part of the practice, and also for work that falls outside the scope of SRA regulation. Money received in respect of the non-SRA regulated work, including money for disbursements, is out-of-scope money and must be dealt with in accordance with rule 17.

(xii) See Chapter 1, indicative behaviour 1.21 of the SRA Code of Conduct in relation to ensuring that disbursements included in a bill reflect the actual amount spent or to be spent.

Rule 18: Receipt of mixed payments

18.1 A "mixed payment" is one which includes ***client money*** as well as ***office money*** and/or ***out-of-scope money***.

18.2 A ***mixed payment*** must either:

(a) be split between a ***client account*** and ***office account*** as appropriate; or

(b) be placed ***without delay*** in a ***client account***.

18.3 If the entire payment is placed in a ***client account***, all ***office money*** and/or ***out-of-scope money*** must be transferred out of the ***client account*** within 14 days of receipt.

Guidance notes

(i) See rule 17.1(b) and (c) for additional ways of dealing with (among other things) mixed payments received in response to a bill or other notification of costs.

(ii) See rule 19.1(b) for (among other things) mixed payments received from the Legal Aid Agency.

(iii) Some out-of-scope money may be subject to the rules of other regulators which may require an earlier withdrawal from the client account operated under these rules.

Rule 19: Treatment of payments to legal aid practitioners

Payments from the Legal Aid Agency

19.1 Two special dispensations apply to payments (other than ***regular payments***) from the Legal Aid Agency:

(a) An advance payment, which may include ***client money***, may be placed in an ***office account***, provided the Legal Aid Agency instructs in writing that this may be done.

(b) A payment for ***costs*** (interim and/or final) may be paid into an ***office account*** at a ***bank*** or ***building society*** branch (or head office) in England and Wales, regardless of whether it consists wholly of ***office money***, or is mixed with ***client money*** in the form of:

(i) advance payments for ***fees*** or ***disbursements***; or

(ii) money for unpaid ***professional disbursements***;

provided all money for payment of ***disbursements*** is transferred to a ***client account*** (or the ***disbursements*** paid) within 14 days of receipt.

19.2 The following provisions apply to ***regular payments*** from the Legal Aid Agency:

(a) "Regular payments" (which are ***office money***) are:

(i) standard monthly payments paid by the Legal Aid Agency under the civil legal aid contracting arrangements;

(ii) standard monthly payments paid by the Legal Aid Agency under the criminal legal aid contracting arrangements; and

(iii) any other payments for work done or to be done received from the Legal Aid Agency under an arrangement for payments on a regular basis.

(b) ***Regular payments*** must be paid into an ***office account*** at a ***bank*** or ***building society*** branch (or head office) in England and Wales.

(c) ***You*** must within 28 days of submitting a report to the Legal Aid Agency, notifying completion of a matter, either:

(i) pay any unpaid ***professional disbursement(s)***, or

(ii) transfer to a ***client account*** a sum equivalent to the amount of any unpaid ***professional disbursement(s)***,

relating to that matter.

(d) In cases where the Legal Aid Agency permits *you* to submit reports at various stages during a matter rather than only at the end of a matter, the requirement in rule 19.2(c) above applies to any unpaid *professional disbursement(s)* included in each report so submitted.

Payments from a third party

19.3 If the Legal Aid Agency has paid any *costs* to *you* or a previously nominated *firm* in a matter (advice and assistance or legal help *costs*, advance payments or interim *costs*), or has paid *professional disbursements* direct, and *costs* are subsequently settled by a third party:

(a) The entire third party payment must be paid into a *client account*.

(b) A sum representing the payments made by the Legal Aid Agency must be retained in the *client account*.

(c) Any balance belonging to *you* must be transferred to an *office account* within 14 days of *your* sending a report to the Legal Aid Agency containing details of the third party payment.

(d) The sum retained in the *client account* as representing payments made by the Legal Aid Agency must be:

(i) **either** recorded in the individual *client's* ledger account, and identified as the Legal Aid Agency's money;

(ii) **or** recorded in a ledger account in the Legal Aid Agency's name, and identified by reference to the *client* or matter;

and kept in the *client account* until notification from the Legal Aid Agency that it has recouped an equivalent sum from subsequent payments due to *you*. The retained sum must be transferred to an *office account* within 14 days of notification.

19.4 Any part of a third party payment relating to unpaid *professional disbursements* or outstanding *costs* of the *client's* previous *firm* is *client money*, and must be kept in a *client account* until *you* pay the *professional disbursement* or outstanding *costs*.

Guidance notes

(i) This rule deals with matters which specifically affect legal aid practitioners. It should not be read in isolation from the remainder of the rules which apply to everyone, including legal aid practitioners.

(ii) In cases carried out under public funding certificates, firms can apply for advance payments ("Payments on Account" under the Standard Civil Contract). The Legal Aid Agency has agreed that these payments may be placed in office account.

(iii) Rule 19.1(b) deals with the specific problems of legal aid practitioners by allowing a mixed or indeterminate payment of costs (or even a payment consisting entirely of unpaid professional disbursements) to be paid into an office account, which for the purpose of rule 19.1(b) must be an account at a bank or building society. However, it is always open to you to comply with rule 17.1(a) to (c), which are the options for everyone for the receipt of costs. For regular payments, see guidance notes (v)-(vii) below.

(iv) Firms are required by the Legal Aid Agency to report promptly to the Legal Aid Agency on receipt of costs from a third party. It is advisable to keep a copy of the report on the file as proof of compliance with the Legal Aid Agency's requirements, as well as to demonstrate compliance with the rule.

(v) Rule 19.2(c) permits a firm, which is required to transfer an amount to cover unpaid professional disbursements into a client account, to make the transfer from its own resources if the regular payments are insufficient.

(vi) The 28 day time limit for paying, or transferring an amount to a client account for, unpaid professional disbursements is for the purposes of these rules only. An earlier deadline may be imposed by contract with the Legal Aid Agency or with counsel, agents or experts. On the other hand, you may have agreed to pay later than 28 days from the submission of the report notifying completion of a matter, in which case rule 19.2(c) will require a transfer of the appropriate amount to a client account (but not payment) within 28 days.

(vii) For the appropriate accounting records for regular payments, see rule 29.7.

Rule 20: Withdrawals from a client account

20.1 *Client money* may only be withdrawn from a *client account* when it is:

(a) properly required for a payment to or on behalf of the *client* (or other person on whose behalf the money is being held);

(b) properly required for a payment in the execution of a particular *trust*, including the purchase of an investment (other than money) in accordance with the *trustee's* powers;

(c) properly required for payment of a *disbursement* on behalf of the *client* or *trust*;

(d) properly required in full or partial reimbursement of money spent by *you* on behalf of the *client* or *trust*;

(e) transferred to another *client account*;

(f) withdrawn on the *client's* instructions, provided the instructions are for the *client's* convenience and are given in writing, or are given by other means and confirmed by *you* to the *client* in writing;

(g) transferred to an account other than a *client account* (such as an account outside England and Wales), or retained in cash, by a *trustee* in the proper performance of his or her duties;

(h) a refund to *you* of an advance no longer required to fund a payment on behalf of a *client* or *trust* (see rule 14.2(b));

(i) money which has been paid into the account in breach of the rules (for example, money paid into the wrong *separate designated client account*) - see rule 20.5 below;

(j) money not covered by (a) to (i) above, where *you* comply with the conditions set out in rule 20.2; or

(k) money not covered by (a) to (i) above, withdrawn from the account on the written authorisation of the *SRA*. The *SRA* may impose a condition that *you* pay the money to a charity which gives an indemnity against any legitimate claim subsequently made for the sum received.

20.2 A withdrawal of *client money* under rule 20.1(j) above may be made only where the amount held does not exceed £500 in relation to any one individual *client* or *trust* matter and *you*:

(a) establish the identity of the owner of the money, or make reasonable attempts to do so;

(b) make adequate attempts to ascertain the proper destination of the money, and to return it to the rightful owner, unless the reasonable costs of doing so are likely to be excessive in relation to the amount held;

(c) pay the funds to a charity;

(d) record the steps taken in accordance with rule 20.2(a)-(c) above and retain those records, together with all relevant documentation (including receipts from the charity), in accordance with rule 29.16 and 29.17(a); and

(e) keep a central register in accordance with rule 29.22.

20.3 *Office money* may only be withdrawn from a *client account* when it is:

(a) money properly paid into the account to open or maintain it under rule 14.2(a);

(b) properly required for payment of *your costs* under rule 17.2 and 17.3;

(c) the whole or part of a payment into a *client account* under rule 17.1(c);

(d) part of a *mixed payment* placed in a *client account* under rule 18.2(b); or

(e) money which has been paid into a *client account* in breach of the rules (for example, *interest* wrongly credited to a *general client account*) - see rule 20.5 below.

20.4 *Out-of-scope money* must be withdrawn from a *client account* in accordance with rules 17.1(a), 17.1(c) and 18 as appropriate.

20.5 Money which has been paid into a *client account* in breach of the rules must be withdrawn from the *client account* promptly upon discovery.

20.6 Money withdrawn in relation to a particular *client* or *trust* from a *general client account* must not exceed the money held on behalf of that *client* or *trust* in all *your general client accounts* (except as provided in rule 20.7 below).

20.7 *You* may make a payment in respect of a particular *client* or *trust* out of a *general client account*, even if no money (or insufficient money) is held for that *client* or *trust* in *your general client account(s)*, provided:

(a) sufficient money is held for that *client* or *trust* in a *separate designated client account*; and

(b) the appropriate transfer from the *separate designated client account* to a *general client account* is made immediately.

20.8 Money held for a *client* or *trust* in a *separate designated client account* must not be used for payments for another *client* or *trust*.

20.9 A *client account* must not be overdrawn, except in the following circumstances:

(a) A *separate designated client account* operated in *your* capacity as *trustee* can be overdrawn if *you* make payments on behalf of the *trust* (for example, inheritance tax) before realising sufficient assets to cover the payments.

(b) If a *sole practitioner* dies and his or her *client accounts* are frozen, overdrawn *client accounts* can be operated in accordance with the rules to the extent of the money held in the frozen accounts.

Guidance notes

(i) Withdrawals in favour of firm, and for payment of disbursements

(a) Disbursements to be paid direct from a client account, or already paid out of your own money, can be withdrawn under rule 20.1(c) or (d) in advance of preparing a bill of costs. Money to be withdrawn from a client account for the payment of costs (fees and disbursements) under rule 17.2 and 17.3 becomes office money and is dealt with under rule 20.3(b).

(b) Money is "spent" under rule 20.1(d) at the time when you despatch a cheque, unless the cheque is to be held to

your order. Money is also regarded as "spent" by the use of a credit account, so that, for example, search fees, taxi fares and courier charges incurred in this way may be transferred to your office account.

(c) See rule 21.4 for the way in which a withdrawal from a client account in your favour must be effected.

(ii) Cheques payable to banks, building societies, etc.

(a) In order to protect client money against misappropriation when cheques are made payable to banks, building societies or other large institutions, it is strongly recommended that you add the name and number of the account after the payee's name.

(iii) Drawing against uncleared cheques

(a) You should use discretion in drawing against a cheque received from or on behalf of a client before it has been cleared. If the cheque is not met, other clients' money will have been used to make the payment in breach of the rules (see rule 7 (duty to remedy breaches)). You may be able to avoid a breach of the rules by instructing the bank or building society to charge all unpaid credits to your office or personal account.

(iv) Non-receipt of electronic payments

(a) If you withdraw money from a general client account on the strength of information that an electronic payment is on its way, but the electronic payment does not arrive, you will have used other clients' money in breach of the rules. See also rule 7 (duty to remedy breaches).

(v) Withdrawals on instructions

(a) One of the reasons why a client might authorise a withdrawal under rule 20.1(f) might be to have the money transferred to a type of account other than a client account. If so, the requirements of rule 15 must be complied with.

(vi) Withdrawals where the rightful owner cannot be traced, on the SRA's authorisation and without SRA authorisation

(a) Applications for authorisation under rule 20.1(k) should be made to the Professional Ethics Guidance Team, who can advise on the criteria which must normally be met for authorisation to be given. You may under rule 20.1(j) pay to a charity sums of £500 or less per client or trust matter

without the SRA's authorisation, provided the safeguards set out in rule 20.2 are followed.

(b) You will need to apply to the SRA, whatever the amount involved, if the money to be withdrawn is not to be paid to a charity. This situation might arise, for example, if you have been unable to deliver a bill of costs because the client has become untraceable and so cannot make a transfer from client account to office account in accordance with rule 17.2-17.3.

(c) After a practice has been wound up, surplus balances are sometimes discovered in an old client account. This money remains subject to rule 20 and rule 21. An application can be made to the SRA under rule 20.1(k).

Rule 21: Method of and authority for withdrawals from client account

21.1 A withdrawal from a ***client account*** may be made only after a specific authority in respect of that withdrawal has been signed by an appropriate person or persons in accordance with the ***firm's*** procedures for signing on ***client account***. An authority for withdrawals from ***client account*** may be signed electronically, subject to appropriate safeguards and controls.

21.2 ***Firms*** must put in place appropriate systems and procedures governing withdrawals from ***client account***, including who should be permitted by the ***firm*** to sign on ***client account***. A non-***manager*** owner or a non-employee owner of a ***licensed body*** is not an appropriate person to be a signatory on ***client account*** and must not be permitted by the ***firm*** to act in this way.

21.3 There is no need to comply with rule 21.1 above when transferring money from one ***general client account*** to another ***general client account*** at the same ***bank*** or ***building society***.

21.4 A withdrawal from a ***client account*** in ***your*** favour must be either by way of a cheque, or by way of a transfer to the ***office account*** or to ***your*** personal account. The withdrawal must not be made in cash.

Guidance notes

(i) A firm should select suitable people to authorise withdrawals from the client account. Firms will wish to consider whether any employee should be able to sign on client account, and whether signing rights should be given to all managers of the practice or limited to those managers directly involved in providing legal services. Someone who has no day-to-day involvement in the business of the practice is unlikely to be regarded as a suitable signatory because of the lack of proximity to client matters. An appropriate understanding of the requirements of the rules is

essential – see paragraph 4.2 of the Guidelines for accounting procedures and systems at Appendix 3.

(ii) Instructions to the bank or building society to withdraw money from a client account (rule 21.1) may be given over the telephone, provided a specific authority has been signed in accordance with this rule before the instructions are given. It is of paramount importance that there are appropriate in-built safeguards, such as passwords, to give the greatest protection possible for client money. Suitable safeguards will also be needed for practices which operate a CHAPS terminal or other form of electronic instruction for payment.

(iii) In the case of a withdrawal by cheque, the specific authority (rule 21.1) is usually a signature on the cheque itself. Signing a blank cheque is not a specific authority.

(iv) A withdrawal from a client account by way of a private loan from one client to another can only be made if the provisions of rule 27.2 are complied with.

(v) If, in your capacity as trustee, you instruct an outside administrator to run, or continue to run, on a day-to-day basis, the business or property portfolio of an estate or trust, you will not need to comply with rule 21.1, provided all cheques are retained in accordance with rule 29.18. (See also rule 29, guidance note (ii)(d).)

(vi) You may set up a "direct debit" system of payment for Land Registry application fees on either the office account or a client account. If a direct debit payment is to be taken from a client account for the payment of Land Registry application fees, a signature, which complies with the firm's systems and procedures set up under rule 21, on the application for registration will constitute the specific authority required by rule 21.1. As with any other payment method, care must be taken to ensure that sufficient uncommitted funds are held in the client account for the particular client before signing the authority. You should also bear in mind that should the Land Registry take an incorrect amount in error from a firm's client account (for example, a duplicate payment), the firm will be in breach of the rules if other clients' money has been used as a result.

(vii) If you fail to specify the correct Land Registry fee on the application for registration (either by specifying a lesser amount than that actually due, or failing to specify any fee at all), you will be in breach of rule 21.1 if the Land Registry takes a sum from your client account greater than that specified on the application, without a specific authority for the revised sum being in place as required by rule 21. In order that you can comply with the rules, the

Land Registry will need to contact you before taking the revised amount, so that the necessary authority may be signed prior to the revised amount being taken.

(viii) Where the Land Registry contacts you by telephone, and you wish to authorise an immediate payment by direct debit over the telephone, you will first need to check that there is sufficient money held in client account for the client and, if there is, that it is not committed to some other purpose.

(ix) The specific authority required by rule 21.1 can be signed after the telephone call has ended but must be signed before the additional payment (or correct full payment) is taken by the Land Registry. It is advisable to sign the authority promptly and, in any event, on the same day as the telephone instruction is given to the Land Registry to take the additional (or correct full) amount. If you decide to fund any extra amount from the office account, the transfer of office money to the client account would need to be made, preferably on the same day but, in any event, before the direct debit is taken. Your internal procedures would need to make it clear how to deal with such situations; for example, who should be consulted before a direct debit for an amount other than that specified on the application can be authorised, and the mechanism for ensuring the new authority is signed by a person permitted by the firm to sign on client account.

(x) You may decide to set up a direct debit system of payment on the office account because, for example, you do not wish to allow the Land Registry to have access to the firm's client account. Provided you are in funds, a transfer from the client account to the office account may be made under rule 20.1(d) to reimburse you as soon as the direct debit has been taken.

(xi) Variable "direct debit" payments to the Land Registry, as described in guidance notes (vi)-(x) above, are not direct debits in the usual sense as each payment is authorised and confirmed individually. A traditional direct debit or standing order should not be set up on a client account because of the need for a specific authority for each withdrawal.

Part 3: Interest

Rule 22: When interest must be paid

22.1 When *you* hold money in a *client account* for a *client*, or for a person funding all or part of *your fees*, or for a *trust*, *you* must account to the *client* or that person or *trust* for *interest* when it is fair and reasonable to do so in all the circumstances. (This also applies if money should have been held in a *client account* but was not.

It also applies to money held in an account in accordance with rule 15.1(a) (or which should have been held in such an account), or rule 16.1(d).)

22.2 *You* are not required to pay *interest*:

(a) on money held for the payment of a *professional disbursement*, once counsel etc. has requested a delay in settlement;

(b) on money held for the Legal Aid Agency;

(c) on an advance from *you* under rule 14.2(b) to fund a payment on behalf of the *client* or *trust* in excess of funds held for that *client* or *trust*; or

(d) if there is an agreement to contract out of the provisions of this rule under rule 25.

22.3 *You* must have a written policy on the payment of *interest*, which seeks to provide a fair outcome. The terms of the policy must be drawn to the attention of the *client* at the outset of a retainer, unless it is inappropriate to do so in the circumstances.

Guidance notes

(i) Requirement to pay interest

(a) Money is normally held for a client as a necessary, but incidental, part of the retainer, to facilitate the carrying out of the client's instructions. The main purpose of the rules is to keep that money safe and available for the purpose for which it was provided. The rules also seek to provide for the payment of a fair sum of interest, when appropriate, which is unlikely to be as high as that obtainable by the client depositing those funds.

(b) An outcomes-focused approach has been adopted in this area, allowing firms the flexibility to set their own interest policies in order to achieve a fair outcome for both the client and the firm.

(c) In addition to your obligation under rule 22.3, it is good practice to explain your interest arrangements to clients. These will usually be based on client money being held in an instant access account to facilitate a transaction. Clients are unlikely to receive as much interest as might have been obtained had they held and invested the money themselves. A failure to explain the firm's policy on interest may lead to unrealistic expectations and, possibly, a complaint to the Legal Ombudsman.

(d) The Legal Services Act 2007 has abolished the distinction in the Solicitors Act 1974 between interest earned on client money held in a general client account or a separate

designated client account, meaning that interest earned on the latter type of account is, in theory, to be accounted for like interest on any other client money on a "fair and reasonable" basis. In practice, however, a firm which wishes to retain any part of the interest earned on client money will need to hold that money in a general client account and continue to have interest paid to the office account (see rule 12.7(b)). The tax regime still treats interest arising on money held in a separate designated client account as belonging to the client, and requires banks to deduct tax at source from that interest (subject to the tax status of the individual client) and credit the interest to the separate designated client account. This makes it impracticable for firms to retain any part of the interest earned on a separate designated client account.

(e) Some firms may wish to apply a de minimis by reference to the amount held and period for which it was held, for example, providing that no interest is payable if the amount calculated on the balance held is £20 or less. Any de minimis will need to be set at a reasonable level and regularly reviewed in the light of current interest rates.

(f) It is likely to be appropriate for firms to account for all interest earned in some circumstances, for example, where substantial sums of money are held for lengthy periods of time.

(g) If sums of money are held in relation to separate matters for the same client, it is normally appropriate to treat the money relating to the different matters separately but there may be cases when the matters are so closely related that they ought to be considered together, for example, when you are acting for a client in connection with numerous debt collection matters. Similarly, it may be fair and reasonable in the circumstances to aggregate sums of money held intermittently during the course of acting for a client.

(h) There is no requirement to pay interest on money held on instructions under rule 15.1(a) in a manner which attracts no interest.

(i) Accounts opened in the client's name under rule 15.1(b) (whether operated by you or not) are not subject to rule 22, as the money is not held by you. All interest earned belongs to the client. The same applies to any account in the client's own name operated by you as signatory under rule 10.

(ii) Interest policy (rule 22.3)

(a) It is important that your clients should be aware of the terms of your interest policy. This should normally be covered at the outset of a retainer, although it may be unnecessary where you have acted for the client previously. It is open to you and your client to agree that interest will be dealt with in a different way (see rule 25).

(iii) Unpresented cheques

(a) A client may fail to present a cheque to his or her bank for payment. Whether or not it is reasonable to recalculate the amount due will depend on all the circumstances of the case. A reasonable charge may be made for any extra work carried out if you are legally entitled to make such a charge.

(iv) Liquidators, trustees in bankruptcy, Court of Protection deputies and trustees of occupational pension schemes

(a) Under rule 8, Part 3 of the rules does not normally apply to liquidators, etc. You must comply with the appropriate statutory rules and regulations, and rule 8.3 and 8.4 as appropriate.

(v) Joint accounts

(a) Under rule 9, Part 3 of the rules does not apply to joint accounts. If you hold money jointly with a client, interest earned on the account will be for the benefit of the client unless otherwise agreed. If money is held jointly with another practice, the allocation of interest earned will depend on the agreement reached.

(vi) Failure to pay interest

(a) A client, including one of joint clients, or a person funding all or part of your fees, may complain to the Legal Ombudsman if he or she believes that interest was due and has not been paid, or that the amount paid was insufficient. It is advisable for the client (or other person) to try to resolve the matter with you before approaching the Legal Ombudsman.

~~(vii) Role of the reporting accountant~~

~~(a) Paragraph 2.8 of the Guidelines for accounting procedures and systems at Appendix 3 states the need for policies and systems in relation to the payment of interest.~~

~~(b) The reporting accountant does not check for compliance with the interest provisions but has a duty under rule 40 to report any substantial departures from the Guidelines discovered whilst carrying out work in preparation of the accountant's report. The accountant is not, however, required to determine the adequacy of a firm's interest policy (see rule 41.1(d)).~~

Rule 23: Amount of interest

23.1 The *interest* paid must be a fair and reasonable sum calculated over the whole period for which the money is held.

Guidance notes

(i) You will usually account to the client for interest at the conclusion of the client's matter, but might in some cases consider it appropriate to account to the client at intervals throughout.

(ii) The sum paid by way of interest need not necessarily reflect the highest rate of interest obtainable but it is unlikely to be appropriate to look only at the lowest rate of interest obtainable. A firm's policy on the calculation of interest will need to take into account factors such as:

(a) the amount held;

(b) the length of time for which cleared funds were held;

(c) the need for instant access to the funds;

(d) the rate of interest payable on the amount held in an instant access account at the bank or building society where the client account is kept;

(e) the practice of the bank or building society where the client account is kept in relation to how often interest is compounded.

(iii) A firm needs to have regard to the effect of the overall banking arrangements negotiated between it and the bank, on interest rates payable on individual balances. A fair sum of interest is unlikely to be achieved by applying interest rates which are set at an artificially low level to reflect, for example, more favourable terms in relation to the firm's office account.

(iv) A firm might decide to apply a fixed rate of interest by reference, for example, to the base rate. In setting that rate, the firm would need to consider (and regularly review) the level of interest it actually receives on its client accounts, but also take into account

its overall banking arrangements so far as they affect the rates received.

(v) When looking at the period over which interest must be calculated, it will usually be unnecessary to check on actual clearance dates. When money is received by cheque and paid out by cheque, the normal clearance periods will usually cancel each other out, so that it will be satisfactory to look at the period between the dates when the incoming cheque is banked and the outgoing cheque is drawn.

(vi) Different considerations apply when payments in and out are not both made by cheque. So, for example, the relevant periods would normally be:

(a) from the date when you receive incoming money in cash until the date when the outgoing cheque is sent;

(b) from the date when an incoming telegraphic transfer begins to earn interest until the date when the outgoing cheque is sent;

(c) from the date when an incoming cheque or banker's draft is or would normally be cleared until the date when the outgoing telegraphic transfer is made or banker's draft is obtained.

(vii) Rule 13.8 requires that money held in a client account must be immediately available, even at the sacrifice of interest, unless the client otherwise instructs, or the circumstances clearly indicate otherwise. The need for access can be taken into account in assessing the appropriate rate for calculating interest to be paid.

(viii) For failure to pay a sufficient sum by way of interest, see guidance note (vi)(a) to rule 22.

Rule 24: Interest on stakeholder money

24.1 When *you* hold money as stakeholder, *you* must pay *interest* on the basis set out in rule 22 to the person to whom the stake is paid, unless the parties have contracted out of this provision (see rule 25.3).

Rule 25: Contracting out

25.1 In appropriate circumstances *you* and *your client* may by a written agreement come to a different arrangement as to the matters dealt with in rule 22 (payment of interest).

25.2 *You* must act fairly towards *your clients* when entering into an agreement to depart from the *interest* provisions, including providing sufficient information at the outset to enable them to give informed consent.

25.3 When acting as stakeholder *you* may, by a written agreement with *your* own *client* and the other party to the transaction, come to a different arrangement as to the matters dealt with in rule 22.

Guidance notes

(i) Whether it is appropriate to contract out depends on all the circumstances, for example, the size of the sum involved or the nature, status or bargaining position of the client. It might, for instance, be appropriate to contract out by standard terms of business if the client is a substantial commercial entity and the interest involved is modest in relation to the size of the transaction. The larger the sum of interest involved, the more there would be an onus on you to show that a client who had accepted a contracting out provision was properly informed and had been treated fairly.

(ii) Contracting out which on the face of it appears to be against the client's interests is permissible where the client has given informed consent. For example, some clients may wish to contract out for reasons related to their tax position or to comply with their religious beliefs.

(iii) A firm which decides not to receive or pay interest, due to the religious beliefs of its principals, will need to ensure that clients are informed at the outset, so that they can choose to instruct another firm if the lack of interest is an issue for them.

(iv) Another example of contracting out is when the client stipulates, and the firm agrees, that all interest earned should be paid to the client despite the terms of the firm's interest policy.

(v) In principle, you are entitled to make a reasonable charge to the client for acting as stakeholder in the client's matter.

(vi) Alternatively, it may be appropriate to include a special provision in the contract that you retain the interest on the deposit to cover your charges for acting as stakeholder. This is only acceptable if it will provide a fair and reasonable payment for the work and risk involved in holding a stake. The contract could stipulate a maximum charge, with any interest earned above that figure being paid to the recipient of the stake.

(vii) Any right to charge the client, or to stipulate for a charge which may fall on the client, would be excluded by, for instance, a prior agreement with the client for a fixed fee for the client's matter, or for an estimated fee which cannot be varied upwards in the absence of special circumstances. It is therefore not normal practice for a stakeholder in conveyancing transactions to receive a separate payment for holding the stake.

(viii) A stakeholder who seeks an agreement to exclude the operation of rule 24 should be particularly careful not to take unfair advantage either of the client, or of the other party if unrepresented.

Part 4: Accounting systems and records

Rule 26: Guidelines for accounting procedures and systems

26.1 The *SRA* may from time to time publish guidelines for accounting procedures and systems to assist *you* to comply with Parts 1 to 4 of the rules, and *you* may be required to justify any departure from the guidelines.

Guidance notes

(i) The current guidelines appear at Appendix 3.

~~(ii) The reporting accountant does not carry out a detailed check for compliance, but has a duty to report on any substantial departures from the guidelines discovered whilst carrying out work in preparation of his or her report (see rules 40 and 41.1(e)).~~

Rule 27: Restrictions on transfers between clients

27.1 A paper transfer of money held in a *general client account* from the ledger of one *client* to the ledger of another *client* may only be made if:

(a) it would have been permissible to withdraw that sum from the account under rule 20.1; and

(b) it would have been permissible to pay that sum into the account under rule 14;

(but there is no requirement in the case of a paper transfer for a written authority under rule 21.1).

27.2 No sum in respect of a *private loan* from one *client* to another can be paid out of funds held for the lender either:

(a) by a payment from one *client account* to another;

(b) by a paper transfer from the ledger of the lender to that of the borrower; or

(c) to the borrower directly,

except with the prior written authority of both *clients*.

27.3 If a *private loan* is to be made by (or to) joint *clients*, the consent of each *client* must be obtained.

Rule 28: Executor, trustee or nominee companies

28.1 If *your firm* owns all the shares in a *recognised body* or a *licensed body* which is an executor, trustee or nominee company, *your firm* and the *recognised body* or *licensed body* must not operate shared *client accounts*, but may:

(a) use one set of accounting records for money held, received or paid by the *firm* and the *recognised body* or *licensed body*; and/or

(b) deliver a single accountant's report for both the *firm* and the *recognised body* or *licensed body*.

28.2 If such a *recognised body* or *licensed body* as nominee receives a dividend cheque made out to the *recognised body* or *licensed body*, and forwards the cheque, either endorsed or subject to equivalent instructions, to the share-owner's *bank* or *building society*, etc., the *recognised body* or *licensed body* will have received (and paid) *client money*. One way of complying with rule 29 (accounting records) is to keep a copy of the letter to the share-owner's *bank* or *building society*, etc., on the file, and, in accordance with rule 29.23, to keep another copy in a central book of such letters. (See also rule 29.17(f) (retention of records for six years)).

Rule 29: Accounting records for client accounts, etc.

Accounting records which must be kept

29.1 *You* must at all times keep accounting records properly written up to show *your* dealings with:

(a) *client money* received, held or paid by *you*; including *client money* held outside a *client account* under rule 15.1(a) or rule 16.1(d); and

(b) any *office money* relating to any *client* or *trust* matter.

29.2 All dealings with *client money* must be appropriately recorded:

(a) in a client cash account or in a record of sums transferred from one client ledger account to another; and

(b) on the client side of a separate client ledger account for each *client* (or other person, or *trust*).

No other entries may be made in these records.

29.3 If *separate designated client accounts* are used:

(a) a combined cash account must be kept in order to show the total amount held in *separate designated client accounts*; and

(b) a record of the amount held for each *client* (or other person, or *trust*) must be made either in a deposit column of a client ledger account, or on the

client side of a client ledger account kept specifically for a ***separate designated client account***, for each ***client*** (or other person, or ***trust***).

29.4 All dealings with ***office money*** relating to any ***client*** matter, or to any ***trust*** matter, must be appropriately recorded in an office cash account and on the office side of the appropriate client ledger account.

29.5 A cheque or draft received on behalf of a ***client*** and endorsed over, not passing through a ***client account***, must be recorded in the books of account as a receipt and payment on behalf of the ***client***. The same applies to cash received and not deposited in a ***client account*** but paid out to or on behalf of a ***client***.

29.6 Money which has been paid into a ***client account*** under rule 17.1(c) (receipt of costs), or rule 18.2(b) (mixed money), and for the time being remains in a ***client account***, is to be treated as ***client money***; it must be appropriately identified and recorded on the client side of the client ledger account.

29.7 Money which has been paid into an ***office account*** under rule 17.1(b) (receipt of costs), rule 19.1(a) (advance payments from the Legal Aid Agency), or rule 19.1(b) (payment of costs from the Legal Aid Agency), and for the time being remains in an ***office account*** without breaching the rules, is to be treated as ***office money***. Money paid into an ***office account*** under rule 19.2(b) (regular payments) is ***office money***. All these payments must be appropriately identified and recorded on the office side of the client ledger account for the individual ***client*** or for the Legal Aid Agency.

29.8 ***Client money*** in a currency other than sterling must be held in a separate account for the appropriate currency, and ***you*** must keep separate books of account for that currency.

Current balance

29.9 The current balance on each client ledger account must always be shown, or be readily ascertainable, from the records kept in accordance with rule 29.2 and 29.3 above.

Acting for both lender and borrower

29.10 When acting for both lender and borrower on a mortgage advance, separate client ledger accounts for both ***clients*** need not be opened, provided that:

(a) the funds belonging to each ***client*** are clearly identifiable; and

(b) the lender is an institutional lender which provides mortgages on standard terms in the normal course of its activities.

Statements from banks, building societies and other financial institutions

29.11 ***You*** must, at least every 5 weeks:

(a) obtain hard copy statements (or duplicate statements permitted in lieu of the originals by rule 9.3 or 9.4 from *banks*, *building societies* or other financial institutions, or

(b) obtain and save in the *firm's* accounting records, in a format which cannot be altered, an electronic version of the *bank's*, *building society's* or other financial institution's on-line record,

in respect of:

(i) any *general client account* or *separate designated client account*;

(ii) any joint account held under rule 9;

(iii) any account which is not a *client account* but in which *you* hold *client money* under rule 15.1(a) or rule 16.1(d); and

(iv) any *office account* maintained in relation to the *firm*;

and each statement or electronic version must begin at the end of the previous statement.

This provision does not apply in respect of passbook-operated accounts, nor in respect of the *office accounts* of an *MDP* operated solely for activities not subject to *SRA* regulation.

Reconciliations

29.12 *You* must, at least once every five weeks:

(a) compare the balance on the client cash account(s) with the balances shown on the statements and passbooks (after allowing for all unpresented items) of all *general client accounts* and *separate designated client accounts*, and of any account which is not a *client account* but in which *you* hold *client money* under rule 15.1(a) or rule 16.1(d), and any *client money* held by *you* in cash; and

(b) as at the same date prepare a listing of all the balances shown by the client ledger accounts of the liabilities to *clients* (and other persons, and *trusts*) and compare the total of those balances with the balance on the client cash account; and also

(c) prepare a reconciliation statement; this statement must show the cause of the difference, if any, shown by each of the above comparisons.

29.13 Reconciliations must be carried out as they fall due, or at the latest by the due date for the next reconciliation. In the case of a *separate designated client account* operated with a passbook, there is no need to ask the *bank*, *building society* or other financial institution for confirmation of the balance held. In the case of other *separate designated client accounts*, *you* must either obtain statements at least monthly or written confirmation of the balance direct from the *bank*, *building*

society or other financial institution. There is no requirement to check that *interest* has been credited since the last statement, or the last entry in the passbook.

29.14 All shortages must be shown. In making the comparisons under rule 29.12(a) and (b), *you* must not, therefore, use credits of one *client* against debits of another when checking total client liabilities.

Bills and notifications of costs

29.15 *You* must keep readily accessible a central record or file of copies of:

(a) all bills given or sent by *you* (other than those relating entirely to activities not regulated by the *SRA*); and

(b) all other written notifications of *costs* given or sent by *you* (other than those relating entirely to activities not regulated by the *SRA*).

Withdrawals under rule 20.1(j)

29.16 If *you* withdraw *client money* under rule 20.1(j) *you* must keep a record of the steps taken in accordance with rule 20.2(a)-(c), together with all relevant documentation (including receipts from the charity).

Retention of records

29.17 *You* must retain for at least six years from the date of the last entry:

(a) all documents or other records required by rule 29.1 to 29.10, 29.12, and 29.15 to 29.16 above;

(b) all statements required by rule 29.11(a) above and passbooks, as printed and issued by the *bank*, *building society* or other financial institution; and/or all on-line records obtained and saved in electronic form under rule 29.11(b) above, for:

(i) any *general client account* or *separate designated client account*;

(ii) any joint account held under rule 9;

(iii) any account which is not a *client account* but in which *you* hold *client money* under rule 15.1(a) or rule 16.1(d); and

(iv) any *office account* maintained in relation to the practice, but not the *office accounts* of an *MDP* operated solely for activities not subject to *SRA* regulation;

(c) any records kept under rule 8 (liquidators, trustees in bankruptcy, Court of Protection deputies and trustees of occupational pension schemes) including, as printed or otherwise issued, any statements, passbooks and other accounting records originating outside *your* office;

(d) any written instructions to withhold *client money* from a *client account* (or a copy of *your* confirmation of oral instructions) in accordance with rule 15;

(e) any central registers kept under rule 29.19 to 29.22 below; and

(f) any copy letters kept centrally under rule 28.2 (dividend cheques endorsed over by nominee company).

29.18 *You* must retain for at least two years:

(a) originals or copies of all authorities, other than cheques, for the withdrawal of money from a *client account*; and

(b) all original paid cheques (or digital images of the front and back of all original paid cheques), unless there is a written arrangement with the *bank*, *building society* or other financial institution that:

(i) it will retain the original cheques on *your* behalf for that period; or

(ii) in the event of destruction of any original cheques, it will retain digital images of the front and back of those cheques on *your* behalf for that period and will, on demand by *you*, *your* reporting accountant or the *SRA*, produce copies of the digital images accompanied, when requested, by a certificate of verification signed by an authorised officer.

(c) The requirement to keep paid cheques under rule 29.18(b) above extends to all cheques drawn on a *client account*, or on an account in which *client money* is held outside a *client account* under rule 15.1(a) or rule 16.1(d).

(d) Microfilmed copies of paid cheques are not acceptable for the purposes of rule 29.18(b) above. If a *bank*, *building society* or other financial institution is able to provide microfilmed copies only, *you* must obtain the original paid cheques from the *bank* etc. and retain them for at least two years.

Centrally kept records for certain accounts, etc.

29.19 Statements and passbooks for *client money* held outside a *client account* under rule 15.1(a) or rule 16.1(d) must be kept together centrally, or *you* must maintain a central register of these accounts.

29.20 Any records kept under rule 8 (liquidators, trustees in bankruptcy, Court of Protection deputies and trustees of occupational pension schemes) must be kept together centrally, or *you* must maintain a central register of the appointments.

29.21 The statements, passbooks, duplicate statements and copies of passbook entries relating to any joint account held under rule 9 must be kept together centrally, or *you* must maintain a central register of all joint accounts.

29.22 A central register of all withdrawals made under rule 20.1(j) must be kept, detailing the name of the *client*, other person or *trust* on whose behalf the money is held (if known), the amount, the name of the recipient charity and the date of the payment.

29.23 If a nominee company follows the option in rule 28.2 (keeping instruction letters for dividend payments), a central book must be kept of all instruction letters to the share-owner's *bank* or *building society*, etc.

Computerisation

29.24 Records required by this rule may be kept on a computerised system, apart from the following documents, which must be retained as printed or otherwise issued:

(a) original statements and passbooks retained under rule 29.17(b) above;

(b) original statements, passbooks and other accounting records retained under rule 29.17(c) above; and

(c) original cheques and original hard copy authorities retained under rule 29.18 above.

There is no obligation to keep a hard copy of computerised records. However, if no hard copy is kept, the information recorded must be capable of being reproduced reasonably quickly in printed form for at least six years, or for at least two years in the case of digital images of paid cheques retained under rule 29.18 above.

Suspense ledger accounts

29.25 Suspense client ledger accounts may be used only when *you* can justify their use; for instance, for temporary use on receipt of an unidentified payment, if time is needed to establish the nature of the payment or the identity of the *client*.

Guidance notes

(i) It is strongly recommended that accounting records are written up at least weekly, even in the smallest practice, and daily in the case of larger firms.

(ii) Rule 29.1 to 29.10 (general record-keeping requirements) and rule 29.12 (reconciliations) do not apply to:

(a) liquidators, trustees in bankruptcy, Court of Protection deputies and trustees of occupational pension schemes operating in accordance with statutory rules or regulations under rule 8.1(i);

(b) joint accounts operated under rule 9;

(c) a client's own account operated under rule 10; the record-keeping requirements for this type of account are set out in rule 30;

(d) you in your capacity as a trustee when you instruct an outside administrator to run, or continue to run, on a day-to-day basis, the business or property portfolio of an estate or trust, provided the administrator keeps and retains appropriate accounting records, which are available for inspection by the SRA in accordance with rule 31. (See also guidance note (v) to rule 21.)

(iii) A cheque made payable to a client, which is forwarded to the client by you, is not client money and falls outside the rules, although it is advisable to record the action taken. See rule 14.2(e) for the treatment of a damages cheque, made payable to the client, which you pay into a client account under the Law Society's Conditional Fee Agreement.

(iv) Some accounting systems do not retain a record of past daily balances. This does not put you in breach of rule 29.9.

(v) "Clearly identifiable" in rule 29.10 means that by looking at the ledger account the nature and owner of the mortgage advance are unambiguously stated. For example, if a mortgage advance of £100,000 is received from the ABC Building Society, the entry should be recorded as "£100,000, mortgage advance, ABC Building Society". It is not enough to state that the money was received from the ABC Building Society without specifying the nature of the payment, or vice versa.

(vi) Although you do not open a separate ledger account for the lender, the mortgage advance credited to that account belongs to the lender, not to the borrower, until completion takes place. Improper removal of these mortgage funds from a client account would be a breach of rule 20.

(vii) Section 67 of the Solicitors Act 1974 permits a solicitor or recognised body to include on a bill of costs any disbursements which have been properly incurred but not paid before delivery of the bill, subject to those disbursements being described on the bill as unpaid.

(viii) Rule 29.17(d) - retention of client's instructions to withhold money from a client account - does not require records to be kept centrally; however this may be prudent, to avoid losing the instructions if the file is passed to the client.

(ix) You may enter into an arrangement whereby the bank keeps digital images of paid cheques in place of the originals. The bank should take an electronic image of the front and back of each cheque in black and white and agree to hold such images, and to make printed copies available on request, for at least two years.

Alternatively, you may take and keep your own digital images of paid cheques.

(x) Certificates of verification in relation to digital images of cheques may on occasion be required by the SRA when exercising its investigative and enforcement powers. The reporting accountant will not need to ask for a certificate of verification but will be able to rely on the printed copy of the digital image as if it were the original.

(xi) These rules require an MDP to keep accounting records only in respect of those activities for which it is regulated by the SRA. Where an MDP acts for a client in a matter which includes activities regulated by the SRA, and activities outside the SRA's regulatory reach, the accounting records should record the MDP's dealings in respect of the SRA-regulated part of the client's matter. It may also be necessary to include in those records dealings with out-of-scope money where that money has been handled in connection with, or relates to, the SRA-regulated part of the transaction. An MDP is not required to maintain records in respect of client matters which relate entirely to activities not regulated by the SRA.

Rule 30: Accounting records for clients' own accounts

30.1 When ***you*** operate a ***client's*** own account as signatory under rule 10, ***you*** must retain, for at least six years from the date of the last entry, the statements or passbooks as printed and issued by the ***bank***, ***building society*** or other financial institution, and/or the duplicate statements, copies of passbook entries and cheque details permitted in lieu of the originals by rule 10.3 or 10.4; and any central register kept under rule 30.2 below.

30.2 ***You*** must either keep these records together centrally, or maintain a central register of the accounts operated under rule 10.

30.3 If ***you*** use on-line records made available by the ***bank***, ***building society*** or other financial institution, ***you*** must save an electronic version in the ***firm's*** accounting records in a format which cannot be altered. There is no obligation to keep a hard copy but the information recorded must be capable of being reproduced reasonably quickly in printed form for at least six years.

30.4 If, when ***you*** cease to operate the account, the ***client*** requests the original statements or passbooks, ***you*** must take photocopies and keep them in lieu of the originals.

30.5 This rule applies only to private practice.

Part 5: Monitoring and investigation by the SRA

Rule 31: Production of documents, information and explanations

31.1 *You* must at the time and place fixed by the *SRA* produce to any person appointed by the *SRA* any records, papers, *client* and *trust* matter files, financial accounts and other documents, and any other information, necessary to enable preparation of a report on compliance with the rules.

31.2 A requirement for production under rule 31.1 above must be in writing, and left at or sent by post or document exchange to the most recent address held by the *SRA's* Information Directorate, or sent electronically to the *firm's* e-mail or fax address, or delivered by the *SRA's* appointee. A notice under this rule is deemed to be duly served:

(a) on the date on which it is delivered to or left at *your* address;

(b) on the date on which it is sent electronically to *your* e-mail or fax address; or

(c) 48 hours (excluding Saturdays, Sundays and Bank Holidays) after it has been sent by post or document exchange.

31.3 Material kept electronically must be produced in the form required by the *SRA's* appointee.

31.4 The *SRA's* appointee is entitled to seek verification from *clients* and staff, and from the *banks*, *building societies* and other financial institutions used by *you*. *You* must, if necessary, provide written permission for the information to be given.

31.5 The *SRA's* appointee is not entitled to take original documents away but must be provided with photocopies on request.

31.6 *You* must be prepared to explain and justify any departures from the Guidelines for accounting procedures and systems published by the *SRA* (see rule 26).

31.7 Any report made by the *SRA's* appointee may, if appropriate, be sent to the Crown Prosecution Service or the Serious Fraud Office and/or used in proceedings before the Solicitors Disciplinary Tribunal. In the case of an *REL* or *RFL*, the report may also be sent to the competent authority in that lawyer's home state or states. In the case of a *solicitor* who is established in another state under the *Establishment Directive*, the report may also be sent to the competent authority in the host state. The report may also be sent to any of the accountancy bodies set out in rule 34.1(a) and/or taken into account by the *SRA* in relation to a possible disqualification of a reporting accountant under rule 34.3.

31.8 Without prejudice to rule 31.1 above, *you* must produce documents relating to any account kept by *you* at a *bank* or with a *building society*:

(a) in connection with *your* practice; or

(b) in connection with any *trust* of which *you* are or formerly were a *trustee*,

for inspection by a person appointed by the *SRA* for the purpose of preparing a report on compliance with the rules or on whether the account has been used for or in connection with a breach of any of the Principles or other SRA Handbook requirements made or issued by the *SRA*. Rules 31.2-31.7 above apply in relation to this paragraph in the same way as to rule 31.1.

Guidance notes

(i) The SRA's powers override any confidence or privilege between you and the client.

(ii) The SRA's monitoring and investigation powers are exercised by Forensic Investigations.

(iii) The SRA will normally give a brief statement of the reasons for its investigations and inspections but not if the SRA considers that there is a risk that disclosure could:

(a) breach any duty of confidentiality;

(b) disclose, or risk disclosure of, a confidential source of information;

(c) significantly increase the risk that those under investigation may destroy evidence, seek to influence witnesses, default, or abscond; or

(d) otherwise prejudice or frustrate an investigation or other regulatory action.

Part 6: Accountants' reports

Rule 32: Obtaining and delivery of accountants' reports

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

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

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

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

32.1A Subject to rule 32.2, you are not required to obtain or deliver an accountant's report if :-

(i) all of the ***client money*** held or received during an ***accounting period*** is money ~~held or~~ received from the Legal Aid Agency or in the circumstances set out in rule 19.3; or ~~.~~

(ii) in the *accounting period*, the statement or passbook balance of client money you have held or received does not exceed:

(A) an average of £10,000; and

(B) a maximum of £250,000,

or the equivalent in foreign currency.

32.1B (i) In Rule 32.1A above, a "statement or passbook balance" is the total balance obtained at least once every five weeks, from a bank, building society or other institution of all *general client accounts* and *separate designated client accounts*, and accounts that are not *client accounts* but are holding *client money*, when carrying out reconciliations in accordance with Rules 29.11 to 29.14.

(ii) An average "statement or passbook balance" is the total of all statement or passbook balances obtained in any *accounting period* divided by the number of such balances in that period

32.2 Notwithstanding the provisions of Rules 32.1 and 32.1A, t~~T~~he ***SRA*** may require you to obtain or deliver ~~the delivery of~~ an accountant's report at any time ~~in circumstances other than those set out in rules 32.1 and in the circumstances set out in rule 32.1A~~ if the ***SRA*** has reason to believe that it is in the public interest to do so.

Guidance notes

(i) A qualified accountant's report is a report prepared in accordance with rule 32.1(a) which the reporting accountant forms the judgement that these Rules have not been complied with such that the safety of *client money* is at risk.~~has found necessary to qualify~~. The form of the report is dealt with in rule 440. The circumstances in which the accountant will be required to qualify his or her report are set out in the form at Appendix 5 to these rules; see also the SRA's "Guidance to Reporting Accountants and firms on planning and completion of the annual Accountants' Reports, under Rule 32 of the SRA Accounts Rules 2011"~~.~~

~~(i)~~(ii) To qualify for the exemption in 32.1(A)(ii), you are required to assess at the end of the *accounting period* if the average at least five weekly balance of client money you have held or received is or less than, or equal to £10,000 and that the maximum aggregated total of client money held or received is less than, or equal to £250,000 (or the equivalent in foreign currency). Both thresholds need to be satisfied for the exemption to apply. If you do satisfy the criteria you will be exempted from the requirement of obtaining an

annual accountant's report for that *accounting period*. We expect that firms will inevitably move in and out of the thresholds from year to year and it is your obligation to satisfy yourself, and if required the SRA, that you have properly applied the exemptions. You should ensure you keep full records of your decisions in this regard. For the avoidance of any doubt if you or your firm is exempted from the obligation to obtain an accountant's report under Rule 32.1A, all of the other sections of these rules will continue to apply to you in full.

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

(a) when no report has been obtained or delivered but the SRA has reason to believe that a report should have been obtained or delivered, for example, because- you have failed to deliver a qualified report to the SRA -or where you have failed to obtain a report because you have improperly applied one of the exemptions in Rule 32.1A;

(b) when a report has been delivered but the SRA has reason to believe that it may be inaccurate;

(c) when your conduct gives the SRA reason to believe that it would be appropriate to require you to obtain or deliver a report earlier than would otherwise have been the case~~delivery of a report~~ (for instance three months after the end of the accounting period);

(d) when your conduct gives the SRA reason to believe that it would be appropriate to require the obtaining and delivery of a report, ~~in all circumstances~~ whether or not qualified and despite the fact that an exemption would otherwise apply, or the more frequent obtaining and -delivery of reports (for instance every six months);

(e) when the SRA has reason to believe that the regulatory risk justifies the imposition on a category of firm of a requirement to obtain and deliver reports earlier or at more frequent intervals;

(f) when a condition on a solicitor's practising certificate requires earlier delivery of reports or the obtaining and delivery at more frequent intervals.

~~(iii) For accountant's reports of limited scope see rule 8 (liquidators, trustees in bankruptcy, Court of Protection deputies and trustees of occupational pension schemes), rule 9 (joint accounts) and rule 10 (operation of a client's own account). For exemption from the obligation to deliver a report, see rule 5 (persons exempt from the rules).~~

(iv) The requirement in rule 32 for a registered foreign lawyer to deliver an accountant's report applies only to a registered foreign lawyer practising in one of the ways set out in paragraph (vi)(C) of the definition of "you" in the Glossary.

(v) When client money is held or received by an unincorporated practice, the principals in the practice will have held or received client money. A salaried partner whose name appears in the list of partners on a firm's letterhead, even if the name appears under a separate heading of "salaried partners" or "associate partners", is a principal.

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

(vii) Assistant solicitors, consultants and other employees do not normally hold client money. An assistant solicitor or consultant might be a signatory for a firm's client account, but this does not constitute holding or receiving client money. If a client or third party hands cash to an assistant solicitor, consultant or other employee, it is the sole principal or the partners (rather than the assistant solicitor, consultant or other employee) who are regarded as having received and held the money. In the case of an incorporated practice, whether a company or an LLP, it would be the recognised body or licensed body itself which would be regarded as having held or received the money.

(viii) If, exceptionally, an assistant solicitor, consultant or other employee has a client account (as a trustee), or operates a client's own account as signatory, the assistant solicitor, consultant or other employee will have to obtain and deliver an accountant's report unless the exemptions in Rule 32.1A apply. The assistant solicitor, consultant or other employee can be included in the report of the practice, but will need to ensure that his or her name is added, and an explanation given.

~~(ix) If a cheque or draft is made out to you, and in the course of practice you endorse it over to a client or employer, you have received (and paid) client money. You will have to deliver an accountant's report, even if no other client money has been held or received.~~

~~(x)~~(ix) Rule 32 does not apply to a solicitor or registered European lawyer, employed as an in-house lawyer by a non-solicitor

employer, who operates the account of the employer or a related body of the employer.

~~(xi)~~(x) In exceptional circumstances, ~~When only a small number of transactions is undertaken or a small volume of client money is handled in an accounting period,~~ a waiver of the obligation to obtain a report may sometimes be granted. Applications should be made to the SRA.

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

Rule 33: Accounting periods

The norm

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

(a) begin at the end of the previous *accounting period*; and

(b) cover twelve months.

Rules 33.2 to 33.5 below set out exceptions.

First and resumed reports

33.2 If *you* are under a duty to obtain ~~deliver~~ *your* first report, the *accounting period* must begin

(a) on the date when *you* first held or received *client money* (or operated a *client's* own account as signatory)~~,~~; or

(b) at the end of the last ***accounting period*** in which an exemption under Rule 32.1A applied,

and may cover less than twelve months.

33.3 If *you* are under a duty to obtain ~~deliver~~ *your* first report after a break, the *accounting period* must begin ~~on the date when *you*~~

(a) on the date when ***you***, for the first time after the break, held or received *client money* (or operated a *client's* own account as signatory)~~,~~; or

(b) at the end of the last ***accounting period*** in which an exemption under Rule 32.1A applied,

and may cover less than twelve months.

Change of accounting period

~~33.2~~33.4 If *you* change the period for which *your* accounts are made up (for example, on a merger, or simply for convenience), the *accounting period* immediately preceding the change may be shorter than twelve months, or longer than twelve months up to a maximum of 18 months, provided that the *accounting period* shall not be changed to a period longer than twelve months unless the *SRA* receives written notice of the change before expiry of the deadline for delivery of the accountant's report which would have been expected on the basis of *your* old *accounting period*.

Final reports

~~33.3~~33.5 If *you* for any reason stop holding or receiving *client money* (and operating any *client's* own account as signatory), *you* must obtain and deliver a final report to the SRA. The *accounting period* must end on the date upon which *you* stopped holding or receiving *client money* (and operating any *client's* own account as signatory), and may cover less than twelve months.

Guidance notes

(i) You must obtain and deliver a final report to the SRA when you cease to hold client money. This applies regardless of whether you would otherwise have been exempted from the requirement to obtain an annual accountant's report on the basis you meet the criteria set out in Rule 32.1A above and irrespective of whether the report is qualified or unqualified .

~~(i)~~(ii) For a person who did not previously hold or receive client money, etc., and has become a principal in the firm, the report for the firm will represent, from the date of joining, that person's first report for the purpose of rule 33.2. For a person who was a principal in the firm and, on leaving, stops holding or receiving client money, etc., the report for the firm will represent, up to the date of leaving, that person's final report for the purpose of rule 33.5 above.

~~(ii)~~(iii) When a partnership splits up, it is usually appropriate for the books to be made up as at the date of dissolution, and for an accountant's report to be delivered within six months of that date. If, however, the old partnership continues to hold or receive client money, etc., in connection with outstanding matters, accountant's' reports will continue to be required for those matters; the books should then be made up on completion of the last of those matters and a report delivered within six months of that date. The same would be true for a sole practitioner winding up matters on retirement.

~~(iii)~~(iv) When a practice is being wound up, you may be left with money which is unattributable, or belongs to a client who cannot be traced. It may be appropriate to apply to the SRA for authority to withdraw this money from the client account - see rule 20.1(k) and guidance note (vi)(a) to rule 20.

Rule 34: Qualifications for making a report

34.1 A report must be prepared and signed by an accountant

(a) **who is a member of**:

(i) the Institute of Chartered Accountants in England and Wales;

(ii) the Institute of Chartered Accountants of Scotland;

(iii) the Association of Chartered Certified Accountants;

(iv) the Institute of Chartered Accountants in Ireland; or

(v) the Association of Authorised Public Accountants; **and**

(b) **who is also**:

(i) an individual who is a registered auditor within the terms of section 1239 of the Companies Act 2006; or

(ii) an employee of such an individual; or

(iii) a *partner* in or employee of a *partnership* which is a registered auditor within the terms of section 1239 of the Companies Act 2006; or

(iv) a director or employee of a company which is a registered auditor within the terms of section 1239 of the Companies Act 2006; or

(v) a member or employee of an *LLP* which is a registered auditor within the terms of section 1239 of the Companies Act 2006.

34.2 An accountant is not qualified to make a report if:

(a) at any time between the beginning of the *accounting period* to which the report relates, and the completion of the report:

(i) he or she was a *partner* or employee, or an officer or employee (in the case of a company), or a member or employee (in the case of an *LLP*) in the *firm* to which the report relates; or

(ii) he or she was employed by the same *non-solicitor employer* as the *solicitor* or *REL* for whom the report is being made; or

(iii) he or she was a *partner* or employee, or an officer or employee (in the case of a company), or a member or employee (in the case of an *LLP*) in an accountancy practice which had an ownership interest in, or was part of the group structure of, the *licensed body* to which the report relates; or

(b) he or she has been disqualified under rule 34.3 below and notice of disqualification has been given under rule 34.4 (and has not subsequently been withdrawn).

34.3 The *SRA* may disqualify an accountant from making any accountant's report if:

(a) the accountant has been found guilty by his or her professional body of professional misconduct or discreditable conduct; or

(b) the *SRA* is satisfied that *you* have not complied with the rules in respect of matters which the accountant has negligently failed to specify in a report.

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

34.4 Written notice of disqualification must be left at or sent by recorded delivery to the address of the accountant shown on an accountant's report or in the records of the accountant's professional body. If sent through the post, receipt will be deemed 48 hours (excluding Saturdays, Sundays and Bank Holidays) after posting.

34.5 An accountant's disqualification may be notified to any *firm* likely to be affected and may be printed in the *Society's* Gazette or other publication.

Guidance note

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

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

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

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

(a) I/this firm/this company/this limited liability partnership recognises that, if during the course of preparing an accountant's report:

(i) you discover evidence of fraud or theft in relation to money

(A) held by a solicitor (or registered European lawyer, or registered foreign lawyer, or recognised body, or licensed body, or employee of a solicitor or registered European lawyer, or manager or employee of a recognised body or licensed body) for a client or any other person (including money held on trust), or

(B) held in an account of a client, or an account of another person, which is operated by a solicitor (or registered European lawyer, registered foreign lawyer, recognised body, licensed body, employee of a solicitor or registered European lawyer, or manager or employee of a recognised body or licensed body); or

(ii) you obtain information which you have reasonable cause to believe is likely to be of material significance in determining whether a solicitor (or registered European lawyer, or registered foreign lawyer, or recognised body, or licensed body, or employee of a solicitor or registered European lawyer, or manager or employee of a recognised body or licensed body) is a fit and proper person

(A) to hold money for clients or other persons (including money held on trust), or

(B) to operate an account of a client or an account of another person,

~~(B)~~(iii) you discover a failure by the firm to submit a qualified Accountant's Report to the Solicitors Regulation Authority as required by these Rules

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

(b) you may, and are encouraged to, make that report without prior reference to me/this firm/this company/this limited liability partnership;

(c) you are to report directly to the Solicitors Regulation Authority should your appointment be terminated following the issue of, or indication of intention to issue, a qualified accountant's report, or following the raising of concerns prior to the preparation of an accountant's report;

(d) you are to deliver to me/this firm/this company/this limited liability partnership ~~with~~ your report ~~the completed checklist required by rule 43 of the SRA Accounts Rules 2011;~~ which you should also ~~to~~ retain for at least six ~~three~~ years from the date of its signature ~~a copy of the completed checklist;~~ and to produce the copy to the Solicitors Regulation Authority on request;

(e) you are to retain these terms of engagement for at least six ~~three~~ years after the termination of the retainer and to produce them to the Solicitors Regulation Authority on request; and

(f) following any direct report made to the Solicitors Regulation Authority under (a) or (c) above, you are to provide to the Solicitors Regulation Authority on request any further relevant information in your possession or in the possession of your firm.

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

35.2 The letter of engagement and a copy must be signed by ***you*** and by the accountant. ***You*** must keep the copy of the signed letter of engagement for at least six ~~three~~ years after the termination of the retainer and produce it to the ***SRA*** on request. Both *you* and the reporting accountant must also retain a copy of the accountant's report, whether qualified or not, for at least six years from the date of its signature and produce the copy to the SRA on request.

35.3 The specified terms may be included in a letter from the accountant to ***you*** setting out the terms of the engagement but the text must be adapted appropriately. The letter must be signed in duplicate by both parties, with ***you*** keeping the original and the accountant the copy.

Guidance note

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

Rule 36: Change of accountant

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

~~Rule 37: Place of examination~~

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

~~Rule 38:~~Rule 37: Provision of details of bank accounts, etc.

~~38.1~~37.1 The accountant must request, and ***you*** must provide, details of all accounts kept or operated by ***you*** in connection with ***your*** practice at any ***bank***, ***building society*** or other financial institution at any time during the ***accounting period*** to which the report relates. This includes ***client accounts***, ***office accounts***, accounts

which are not *client accounts* but which contain *client money*, and *clients'* own accounts operated by *you* as signatory.

~~**Rule 39:**~~**Rule 38: Work to be undertaken** ~~**Test procedures**~~

38.1 The accountant should exercise his or her professional judgement in determining the work required for the firm they are instructed to obtain the report on in order to assess risks to *client money* arising from compliance with these Rules. This should cover the work that the accountant considers is appropriate to enable completion of the report required by the SRA at the date the report is commissioned (referred to in Rule 40 below).

Guidance notes

(i) The purpose of the accountant's report is to enable a proportionate degree of oversight by the SRA over risks to clients' funds. It may also help the firm identify any improvements in its control systems that are required. The form of the report that the accountant is required to complete is intended to provide assurance that client funds are properly safeguarded. If the accountant forms the judgement that these Rules have not been complied with such that the safety of client money is at risk, then the accountant is required to "qualify" the report and set out in the report details of the areas where risks have been identified. Rule 32.1 sets out which firms are required to obtain a report but only qualified reports have to be delivered to the SRA within the time frame set out.

(ii) The types of work that the accountant is required to undertake will depend on a number of factors including the size and complexity of the firm, the nature of the work undertaken, the number of transactions and amount of client funds held. The accountant may also want to consider the firm's existing systems and for example, the numbers and types of breaches of these Rules that the firm's COFA has recorded under his/her reporting obligations. Separate guidance as to the work that might be considered as part of a work programme has been issued by the SRA and will be updated from time to time; see the SRA's " Guidance to Reporting Accountants and firms on planning and completion of the annual Accountants' Reports, under Rule 32 of the SRA Accounts Rules 2011"

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

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

~~(i) rule 29 - accounting records for client accounts, etc;~~

~~(ii) rule 30 - accounting records for clients' own accounts;~~

~~and is so designed that:~~

(A) an appropriate client ledger account is kept for each *client* (or other person for whom *client money* is received, held or paid) or *trust*;

(B) the client ledger accounts show separately from other information details of all *client money* received, held or paid on account of each *client* (or other person for whom *client money* is received, held or paid) or *trust*; and

(C) transactions relating to *client money* and any other money dealt with through a *client account* are recorded in the accounting records in a way which distinguishes them from transactions relating to any other money received, held or paid by *you*;

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

(c) compare a sample of payments into and from the *client accounts* as shown in *bank* and *building society* or other financial institutions' statements or passbooks with *your* records of receipts and payments of *client money*, including paid cheques;

(d) test check the system of recording *costs* and of making transfers in respect of *costs* from the *client accounts*;

(e) make a test examination of a selection of documents requested from *you* in order to confirm:

(i) that the financial transactions (including those giving rise to transfers from one client ledger account to another) evidenced by such documents comply with Parts 1 and 2 of the rules, rule 27 (restrictions on transfers between clients) and rule 28 (executor, trustee or nominee companies); and

(ii) that the entries in the accounting records reflect these transactions in a manner complying with rule 29;

(f) subject to rule 39.2 below, extract (or check extractions of) balances on the client ledger accounts during the *accounting period* under review at not fewer than two dates selected by the accountant (one of which may be the last day of the *accounting period*), and at each date:

(i) compare the total shown by the client ledger accounts of the liabilities to the *clients* (and other persons for whom *client money* is held) and *trusts* with the cash account balance; and

(ii) reconcile that cash account balance with the balances held in the *client accounts*, and accounts which are not *client accounts* but in which *client money* is held, as confirmed direct to the accountant

by the relevant ***banks***, ***building societies*** and other financial institutions;

(g) confirm that reconciliation statements have been made and kept in accordance with rule 29.12 and 29.17(a);

(h) make a test examination of the client ledger accounts to see whether payments from the *client account* have been made on any individual account in excess of money held on behalf of that *client* (or other person for whom *client money* is held) or *trust*;

(i) check the office ledgers, office cash accounts and the statements provided by the *bank*, *building society* or other financial institution for any *office account* maintained by *you* in connection with the practice, to see whether any *client money* has been improperly paid into an *office account* or, if properly paid into an *office account* under rule 17.1(b) or rule 19.1, has been kept there in breach of the rules;

(j) check the accounting records kept under rule 29.17(d) and 29.19 for *client money* held outside a *client account* to ascertain what transactions have been effected in respect of this money and to confirm that the *client* has given appropriate instructions under rule 15.1(a);

(k) make a test examination of the client ledger accounts to see whether rule 29.10 (accounting records when acting for both lender and borrower) has been complied with;

(l) for liquidators, trustees in bankruptcy, *Court of Protection deputies* and trustees of occupational pension schemes, check that records are being kept in accordance with rule 29.15, 29.17(c) and 29.20, and cross-check transactions with *client* or *trust* matter files when appropriate;

(m) check that statements and passbooks and/or duplicate statements and copies of passbook entries are being kept in accordance with rule 29.17(b)(ii) and 29.21 (record-keeping requirements for joint accounts), and cross-check transactions with *client* matter files when appropriate;

(n) check that statements and passbooks and/or duplicate statements, copies of passbook entries and cheque details are being kept in accordance with rule 30 (record-keeping requirements for clients' own accounts), and cross-check transactions with *client* matter files when appropriate;

(o) for money withdrawn from *client account* under rule 20.1(j), check that records are being kept in accordance with rule 29.16, 29.17(a) and 29.22, and cross-check with *client* or *trust* matter files when appropriate;

(p) in the case of private practice only, check that for the period which will be covered by the accountant's report the *firm* was covered for the purposes of the *SRA's* indemnity insurance rules in respect of its offices in England and Wales by:

(i) certificates of qualifying insurance outside the assigned risks pool; or

(ii) a policy issued by the assigned risks pool manager; or

(iii) certificates of indemnity cover under the professional requirements of an *REL's* home jurisdiction in accordance with paragraph 1 of Appendix 3 to those rules, together with the ***SRA's*** written grant of full exemption; or

(iv) *certificates of indemnity cover under the professional requirements of an* ***REL's*** home jurisdiction plus certificates of a difference in conditions policy with a qualifying insurer under paragraph 2 of Appendix 3 to those rules, together with the ***SRA's*** written grant of partial exemption; and

(q)(i) ask for any information and explanations required as a result of making the above checks and tests.

Extracting balances

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

(a) confirms that a satisfactory system of control is in operation and the accounting records are in balance;

(b) carries out a test check of the extraction against the individual records; and

(c) states in the report that he or she has relied on this exception.

Guidance notes

(i) The rules do not require a complete audit of your accounts nor do they require the preparation of a profit and loss account or balance sheet.

(ii) In making the comparisons under rule 39.1(f), some accountants improperly use credits of one client against debits of another when checking total client liabilities, thus failing to disclose a shortage. A debit balance on a client account when no funds are held for that client results in a shortage which must be disclosed as a result of the comparison.

(iii) The main purpose of confirming balances direct with banks, etc., under rule 39.1(f)(ii) is to ensure that your records accurately reflect the sums held at the bank. The accountant is not expected to conduct an active search for undisclosed accounts.

(iv) In checking compliance with rule 20.1(j), the accountant should check on a sample basis that you have complied with rule 20.2 and are

~~keeping appropriate records in accordance with rule 29.16, 29.17(a) and 29.22. The accountant is not expected to judge the adequacy of the steps taken to establish the identity of, and to trace, the rightful owner of the money.~~

~~Rule 40: Departures from guidelines for accounting procedures and systems~~

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

~~Rule 41: Matters outside the accountant's remit~~

~~41.1 The accountant is not required:~~

~~(a) to extend his or her enquiries beyond the information contained in the documents produced, supplemented by any information and explanations given by ***you***;~~

~~(b) to enquire into the stocks, shares, other securities or documents of title held by ***you*** on behalf of ***your clients***;~~

~~(c) to consider whether ***your*** accounting records have been properly written up at any time other than the time at which his or her examination of the accounting records takes place;~~

~~(d) to check compliance with the provisions in rule 22 on ***interest***, nor to determine the adequacy of ***your interest*** policy;~~

~~(e) to make a detailed check on compliance with the guidelines for accounting procedures and systems (see rules 26 and 40); or~~

~~(f)~~(b) ~~to determine the adequacy of the steps taken under paragraphs (a) and (b) of rule 20.2~~.

~~Rule 42:~~Rule 39: Failure to provide documentation~~Privileged documents~~

~~42.1~~39.1 *You* must provide documentation to the accountant as required to enable completion of the accountant's report. When acting on a ***client's*** instructions, ***you*** will normally have the right on the grounds of privilege as between ***solicitor*** and ***client*** to decline to produce any document requested by the accountant for the purposes of his or her examination. ~~In these circumstances~~A significant failure to provide documentation may result in~~,~~ the accountant deciding that they should ~~must~~ qualify the report if they consider that as a result, they cannot properly prepare the report in accordance with these rules.~~and set out the circumstances.~~

Guidance note

(i) In a recognised body or licensed body with one or more managers who are not legally qualified, legal professional privilege may not attach to work which is neither done nor supervised by a legally

qualified individual - see Legal Services Act 2007, section 190(3) to (7), and Schedule 22, paragraph 17.

~~**Rule 43: Completion of checklist**~~

~~43.1 ***You*** must obtain the completed checklist, retain it for at least three years from the date of signature and produce it to the ***SRA*** on request.~~

~~Guidance notes~~

~~(i) The current checklist appears at Appendix 4. It is issued by the SRA to firms at the appropriate time for completion by their reporting accountants.~~

~~(ii) The letter of engagement required by rule 35 imposes a duty on the accountant to hand the completed checklist to the firm, to keep a copy for three years and to produce the copy to the SRA on request.~~

~~**Rule 44:**~~**Rule 40: Form of accountant's report**

~~44.1~~40.1 The accountant must complete and sign his or her report in the form published from time to time by the ***SRA***. ~~An explanation of any significant difference between liabilities to ***clients*** and ***client money*** held, as identified at section 2 of the report, must be given by either the accountant or ***you***.~~

Guidance notes

(i) The current form of the accountant's report ~~appears at Appendix 5.~~ under Rule 40 requires ~~The report confirms if~~ the accountant to confirm if he/she has found it necessary to qualify the report. If so, the report must be delivered to the SRA - see rule 32.1(b) and guidance notes ~~(i)~~ to that rule.

(ii) Separate reports can be obtained for each principal in a partnership but most firms choose to obtain one report in the name of all the principals. In either case, the report must be delivered to the SRA if it is qualified - see rule 32.1(b) and the guidance notes to that rule ~~(i)~~. For assistant solicitors, consultants and other employees, see rule 32, guidance notes (vii) and (viii).

(iii) An incorporated practice will obtain only one report, on behalf of the company and its directors, or on behalf of the LLP and its members - see rule 32.1. The report must be delivered to the SRA if it is qualified - see rule 32.1(b) and the guidance notes ~~(i)~~ to that rule.

(iv) Although it may be agreed that the accountant will send a~~ny~~ qualified report~~s~~ direct to the SRA, the responsibility for delivery is that of the firm. The form of report requires the accountant to confirm that a copy of the report (whether qualified or unqualified)

has been sent to the COFA on behalf of the firm to which it relates. The COFA should ensure that the report is seen by each of the managers of the firm.

~~(v) A reporting accountant is not required to report on trivial breaches due to clerical errors or mistakes in book-keeping, provided that they have been rectified on discovery and the accountant is satisfied that no client suffered any loss as a result.~~

~~(vi) In many practices, clerical and book-keeping errors will arise. In the majority of cases these may be classified by the reporting accountant as trivial breaches. However, a "trivial breach" cannot be precisely defined. The amount involved, the nature of the breach, whether the breach is deliberate or accidental, how often the same breach has occurred, and the time outstanding before correction (especially the replacement of any shortage) are all factors which should be considered by the accountant before deciding whether a breach is trivial.~~

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

~~Rule 45:~~Rule 41: Firms with two or more places of business

~~45.1~~41.1 If a ***firm*** has two or more offices:

(a) separate reports may be obtained ~~delivered~~ in respect of the different offices; and

(b) separate ***accounting periods*** may be adopted for different offices, provided that:

(i) separate reports are obtained~~delivered~~;

(ii) every office is covered by a report obtained ~~delivered~~ within six months of the end of its ***accounting period***; and

(iii) there are no gaps between the ***accounting periods*** covered by successive reports for any particular office or offices.

~~Rule 46:~~Rule 42: Waivers

~~46.1~~42.1 The ***SRA*** may waive in writing in any particular case or cases any of the provisions of Part 6 of the rules, and may revoke any waiver.

Guidance note

(i) Applications for waivers should be made to the SRA. In appropriate cases, firms may be granted a waiver of the obligation to obtain an accountant's report and in accordance with the SRA's current Waivers' Policy ~~(see rule 32, and guidance note (xi) to that~~

~~rule). The circumstances in which a waiver of any other provision of Part 6 would be given must be extremely rare.~~

Part 7: Practice ~~from an office outside England and Wales and~~ as an REL from an office in England and Wales of an Exempt European Practice

~~Rule 47:~~Rule 43: Purpose of rules applying to *RELs* in Exempt European Practices ~~of the overseas accounts provisions~~

~~47.1~~43.1 The purpose of applying different accounts provisions to the practice of an *REL* from an office in England and Wales of an *Exempt European Practice* is to ensure similar protection for *client monies* but by way of rules which recognise that the body in which the ***REL*** is practising is not itself a regulated entity.~~:~~

~~(a) to practice from an office outside England and Wales is to ensure similar protection for ***client money (overseas)*** but by way of rules which are more adaptable to conditions in other jurisdictions.~~

~~(b) are more adaptable to such practices.~~

~~Rule 48:~~Rule 44: Application and Interpretation

~~48.1~~44.1 Part 7 of these rules applies to your practice as an ***REL*** from an office ~~in outside~~ England and Wales of an ***Exempt European Practice***~~.to the extent specified in each rule in this Part. If compliance with any applicable provision of Part 7 of these rules would result in your breaching local law, you may disregard that provision to the extent necessary to comply with that local law.~~

~~48.2~~44.2 The SRA Handbook Glossary 2012 shall apply and, unless the context otherwise requires:

(a) all italicised terms shall be defined; and

(b) all terms shall be interpreted,

in accordance with the *Glossary*.

~~48.3~~44.3 ~~Part 7 of these rules applies to the practice of an ***REL*** from an office in England and Wales of an ***Exempt European Practice*** but for this purpose only all references in these rules to ***client monies (overseas)*** shall be substituted with ***client monies***.~~

~~*Guidance note*~~

(i) ~~*If you are an REL practising from an office in England and Wales of an Exempt European Practice and you hold or receive client money you must comply with rules 49.2 and 49.3, 50.3 to 50.6 and 51.*~~

~~Rule 49:~~Rule 45: Client money~~Interest~~

~~49.1~~45.1 You must comply with this Part ~~rule 49.2 below~~, if you have held or received ~~hold~~ ***client money***. ~~***(overseas)*** and you are:~~

~~(a) a ***solicitor sole practitioner practising from an office*** outside England and Wales, or an ***REL sole practitioner practising from an office*** in Scotland or Northern Ireland;~~

~~(b) a ***lawyer-controlled body*** or (in relation to ***practice from an office*** in Scotland or Northern Ireland) a ***lawyer-controlled body***, or an ***REL-controlled body***;~~

~~(c) a ***lawyer of England and Wales*** who is a ***manager (overseas)*** of a ***firm (overseas)*** which is ***practising from an office*** outside the ***UK***, and ***lawyers of England and Wales*** control the ***firm (overseas)***, either directly as ***partners***, members or ***owners***, or indirectly by their ownership of ***bodies corporate*** which are ***partners***, members or ***owners***; or~~

~~(d) a ***lawyer of England and Wales*** or ***REL*** who is a ***manager (overseas)*** of a ***firm (overseas)*** which is ***practising from an office*** in Scotland or Northern Ireland, and ***lawyers of England and Wales*** and/or ***RELs*** control the ***firm (overseas)***, either directly as ***partners***, members or ***owners***, or indirectly by their ownership of ***bodies corporate*** which are ***partners***, members or ***owners***.~~

~~49.2~~45.2 In all dealings with ***client*** money, you must: ~~If it is fair and reasonable for interest to be earned for the client on that ***client money (overseas)***, you must ensure that:~~

(a) keep ***client money*** separate from money which is not ***client money***;

(b) on receipt, pay ***client money*** into a ***client account*** without undue delay and keep 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) ensure by use of proper accounting systems and processes that ***client money*** is used for ***client's*** matters only and for the purposes for which it has been paid;

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

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

(f) return ***client money*** 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) keep 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;

(h) Account for interest on ***client money*** in accordance with rule 22.

~~(i) the ***client money (overseas)*** is dealt with so that fair and reasonable interest is earned upon it, and that the interest is paid to the client;~~

~~(j) the client is paid a sum equivalent to the interest that would have been earned if the ***client money (overseas)*** had earned fair and reasonable interest; or~~

~~(k) any alternative written agreement with the client setting out arrangements regarding the payment of interest on that money is carried out.~~

~~49.3~~45.3 ~~In deciding whether it is fair and reasonable for interest to be earned for a client on ***client money (overseas)***, you must have regard to all the circumstances, including:~~

~~(a) the amount of the money;~~

~~(b) the length of time for which you are likely to hold the money; and~~

~~(c) the law and prevailing custom of lawyers practising in the jurisdiction in which you are practising.~~

~~Rule 50:~~Rule 46: Accountants' Reports

~~Practice from an office in the UK~~

~~50.1~~46.1 You must obtain an accountant's report in respect of any period during which you or your ***~~firm (overseas)~~*** the ***Exempt European Practice*** from which you practice have held or received ***client money*** unless you fall within any of the exceptions contained in Rule 32.1(A).

~~50.2~~46.2 You must comply with the rules in Part 6 in relation to any accountant's report that you are required to obtain under rule 46.1. ~~50.3 and 50.4 below in relation to ***practice from an office*** outside the ***UK*** if you are:~~

~~(a) a ***solicitor sole practitioner*** who has held or received ***client money (overseas)***;~~

~~(b) a ***lawyer-controlled body*** which has held or received ***client money (overseas)*** as a ***firm (overseas)***;~~

~~(c) a ***lawyer of England and Wales***, or a ***non-lawyer***, who is a ***manager (overseas)*** of a ***lawyer-controlled body*** which holds or receives ***client money (overseas)***;~~

~~(d) a ***lawyer of England and Wales*** who is a ***manager (overseas)*** of any other ***firm (overseas)*** which is controlled by ***lawyers of England and Wales***, either directly as ***partners***, members or ***owners***, or indirectly by their ownership of ***bodies corporate*** which are ***partners***, members or ***owners***, if the ***firm (overseas)*** holds or receives ***client money (overseas)***;~~

(e) a ***solicitor*** who holds or receives ***client money (overseas)*** as a named ***trustee***;

(f) a ***lawyer of England and Wales***, or a ***non-lawyer***, who is a ***manager (overseas)*** of a ***lawyer-controlled body*** and who holds or receives ***client money (overseas)*** as a named ***trustee***.

Practice from an office in Scotland or Northern Ireland

50.346.3 You must comply with rule 50.3 and 50.4 below in relation to ***practice from an office*** in Scotland or Northern Ireland if you are:

(a) a ***solicitor*** or ***REL sole practitioner*** who has held or received ***client money (overseas)***;

(b) a ***lawyer-controlled body***, or an ***REL-controlled body***, which has held or received ***client money (overseas)*** as a ***firm (overseas)***;

(c) a ***lawyer of England and Wales***, an ***REL***, a European lawyer registered with the ***BSB*** or a ***non-lawyer***, who is a ***manager (overseas)*** of a ***lawyer-controlled body***, or an ***REL-controlled body***, which holds or receives ***client money (overseas)***;

(d) a ***lawyer of England and Wales*** or ***REL*** who is a ***manager (overseas)*** of any other ***firm (overseas)*** which is controlled by ***lawyers of England and Wales*** and/or ***RELs***, either directly as ***partners***, members or ***owners***, or indirectly by their ownership of ***bodies corporate*** which are ***partners***, members or ***owners***, if the ***firm (overseas)*** holds or receives ***client money (overseas)***;

(e) a ***solicitor*** or ***REL*** who holds or receives ***client money (overseas)*** as a named ***trustee***;

(f) a ***lawyer of England and Wales***, a European lawyer registered with the ***BSB*** or a ***non-lawyer***, who is a ***manager (overseas)*** of a ***lawyer-controlled body***, or an ***REL-controlled body***, and who holds or receives ***client money (overseas)*** as a named ***trustee***.

Dealings with client money

50.446.4 In all dealings with ***client money (overseas)***, you must ensure that:

(a) it is kept in a ***client account (overseas)***, separate from money which is not ***client money (overseas)***;

(b) on receipt, it is paid without delay into a ***client account (overseas)*** and kept there, unless the client has expressly or by implication agreed that the money shall be dealt with otherwise or you pay it straight over to a third party in the execution of a ***trust*** under which it is held;

(c) it is not paid or withdrawn from a ***client account (overseas)*** except:

(i) on the specific authority of the client;

(ii) where the payment or withdrawal is properly required:

(A) for a payment to or on behalf of the client;

(B) for or towards payment of a debt due to the ***firm (overseas)*** from the client or in reimbursement of money expended by the ***firm (overseas)*** on behalf of the client; or

(C) for or towards payment of costs due to the ***firm (overseas)*** from the client, provided that a bill of costs or other written intimation of the amount of the costs incurred has been delivered to the client and it has thereby (or otherwise in writing) been made clear to the client that the money held will be applied in payment of the costs due; or

(iii) in proper execution of a ***trust*** under which it is held;

(d) accounts are kept at all times, whether by written, electronic, mechanical or other means, to:

(i) record all dealings with ***client money (overseas)*** in any ***client account (overseas)***;

(ii) show all ***client money (overseas)*** received, held or paid, distinct from any other money, and separately in respect of each client or ***trust***; and

(iii) ensure that the ***firm (overseas)*** is able at all times to account, without delay, to each and every client or ***trust*** for all money received, held or paid on behalf of that client or ***trust***; and

(e) all accounts, books, ledgers and records kept in relation to the ***firm's (overseas) client account(s) (overseas)*** are preserved for at least six years from the date of the last entry therein.

Accountants' reports

50.5<u>46.5</u> You must deliver an accountant's report in respect of any period during which you or your ***firm (overseas)*** have held or received ***client money (overseas)*** and you were subject to rule 50.3 above, within six months of the end of that period.

50.6<u>46.6</u> The accountant's report must be signed by the reporting accountant, who must be an accountant qualified in England and Wales or in the overseas jurisdiction where your office is based, or by such other person as the ***SRA*** may think fit. The ***SRA*** may for reasonable cause disqualify a person from signing accountants' reports.

~~50.7~~46.7 ~~The accountant's report must be based on a sufficient examination of the relevant documents to give the reporting accountant a reasonable indication whether or not you have complied with rule 50.3 above during the period covered by the report, and must include the following:~~

~~(a) your name, practising address(es) and practising style and the name(s) of the *firm's (overseas) managers (overseas)*;~~

~~(b) the name, address and qualification of the reporting accountant;~~

~~(c) an indication of the nature and extent of the examination the reporting accountant has made of the relevant documents;~~

~~(d) a statement of the total amount of money held at banks or similar institutions on behalf of clients and *trusts*, and of the total liabilities to clients and *trusts*, on any date selected by the reporting accountant (including the last day), falling within the period under review; and an explanation of any difference between the total amount of money held for clients and *trusts* and the total liabilities to clients and *trusts*;~~

~~(e) if the reporting accountant is satisfied that (so far as may be ascertained from the examination) you have complied with rule 50.3 above during the period covered by the report, except for trivial breaches, or situations where you have been bound by a local rule not to comply, a statement to that effect; and~~

~~(f) if the reporting accountant is not sufficiently satisfied to give a statement under (e) above, details of any matters in respect of which it appears to the reporting accountant that you have not complied with rule 50.3 above.~~

~~Rule 51:~~Rule 47: Production of documents, information and explanations

~~51.1~~47.1 You must promptly comply with:

(a) 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:

(i) in connection with your practice; or

(ii) in connection with any *trust* of which you are, or formerly were, a *trustee*;

for the purpose of ascertaining whether any person subject to Part 7 of these rules is complying with or has complied with any provision of this Part of these rules, or whether the account has been used for or in connection with a breach of any of the Principles or other SRA Handbook requirements made or issued by the *SRA*; and

(b) a notice given by the *SRA* in accordance with section 44B or 44BA of the ~~*L*~~*SA* or section 93 of the *LSA* for the provision of documents, information or explanations.

~~51.2~~47.2 You must provide any necessary permissions for information to be given so as to enable the appointee of the *SRA* to:

(a) prepare a report on the documents produced under rule 51.1 above; and

(b) seek verification from clients, staff and the banks, building societies or other financial institutions used by you.

~~51.3~~47.3 You must comply with all requests from the *SRA* or its appointee as to:

(a) the form in which you produce any documents you hold electronically; and

(b) photocopies of any documents to take away.

~~51.4~~47.4 A notice under this rule is deemed to be duly served:

(a) on the date on which it is delivered to or left at your address;

(b) on the date on which it is sent electronically to your e-mail or fax address; or

(c) 48 hours (excluding Saturdays, Sundays and Bank Holidays) after it has been sent by post or document exchange to your last notified practising address.

~~Guidance notes~~

(i) ~~If your firm has offices in and outside England and Wales, a single accountant's report may be submitted covering your practice from offices both in, and outside, England and Wales - such a report must cover compliance both with Parts 1 to 6 of these rules, and with Part 7 of these rules.~~

(ii) ~~The accounting requirements and the obligation to deliver an accountant's report in this part of the rules are designed to apply to you in relation to money held or received by your firm unless it is primarily the practice of lawyers of other jurisdictions. The fact that they do not apply in certain cases is not intended to allow a lower standard of care in the handling of client money - simply to prevent the "domestic provisions" applying "by the back door" in a disproportionate or inappropriate way.~~

(iii) ~~In deciding whether interest ought, in fairness, to be paid to a client, the fact that the interest is or would be negligible, or it is customary in that jurisdiction to deal with interest in a different way, may mean that interest is not payable under rule 49.2.~~

~~Rule 52:~~Rule 48: Waivers

~~52.1~~48.1 The *SRA* may waive in writing in any particular case or cases any of the provisions of Part 7 of the rules, may place conditions on, and may revoke, any waiver.

Guidance note

(i) Applications for waivers should be made to the Professional Ethics Guidance Team. You will need to show that your circumstances are exceptional in order for a waiver to be granted.

Part 8: [Deleted]

Schedule 4

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 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, 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 4: Reporting requirements

Rule 6: Reporting requirements

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***.

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 **r*esponsible 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.~~

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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

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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.

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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.

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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

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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:-

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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.

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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 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)**	**Guidance – indicative of firm with above adequate processes and procedures**	**Guidance – indicative of a firm with adequate processes and controls**	**Guidance – indicative of a firm with below adequate processes and controls that may lead to a qualification**
3.1 Client money in client account	A delay of 5 working days over	• Testing of office account receipts	No incidents noted of client money	Minimal incidents of client money being	• Client money was routinely placed in

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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 client money? Have you seen any round sum transfers between the client account	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 monies being improperly used to finance business operations.	(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 office account to client account transfers to identify number and reasons for such transfers. • Testing client bank reconciliation (for example, to assess if	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 disbursements). No incidents noted of transfers between client accounts and	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 of 5 working days (these include money in an office account that becomes client money through, for	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 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

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and the office account ?***Rule 7, Rule 13, Rule 14, Rule 17, Rule 18***	.	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).	the office account that were not within the Rules and appropriately authorised.	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.	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 -	Law firms should have controls to avoid client debit	• Test the computerised system to assess	Systems and practices are such that debit balances	Debit balances on client ledgers are reviewed at least	• There are no processes in place that would

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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,***	balances arising and that prompt a regular review and investigation of office credit balances.	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 review of	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.	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.	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 identified through ad-hoc

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Rule 18, Rule 20, Rule 21, Rule 27, SRA Guideline 2.7 and 4.5		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.			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	It is important to check if payment withdrawals are made in accordance with authorisation	• Test a sample of client account withdrawals to assess if appropriate client account	A formal client account withdrawals process is fully documented and adhered to. Withdrawals can	A client account withdrawals process exists and is adhered to, but is not formally documented.	• A client account withdrawals process does not exist. • A client account withdrawals

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only in accordance with pre-approved authorisation procedures? ***Rule 20, SRA Guideline 4.1***	procedures.	withdrawals authorisations were in place at the time of the withdrawal. • Consider whether unauthorised withdrawals could be indicative of fraud/dishonesty	only be processed once the proper authorisation has been obtained. Where electronic authorities are permitted, these are only made with a secure IT approval process (note: email approval is not considered secure).	Withdrawals can only be processed once the proper authorisation has been obtained.	process exists but is not adhered to. • Unauthorised withdrawals from 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)	Effective IT systems may include – access controls, firewalls, software and hardware maintenance contracts. Effective manual systems may	• 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	A strong control environment exists which includes the following: - The client accounting system is fully documented and includes notes over billing, payments, transfers,	A reasonable IT control environment exists which includes the following: - Password access to the IT system/s and passwords are changed at least annually.	• 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*

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and security (access) over client accounting records and money? ***Rule 29, SRA Guideline 5.5***	include – a system of operating controls to prevent misuse of client money and monitoring controls that would identify such misuse.	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 any results based on the work that they *have* done	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 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	- 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 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	*complexity of the law firm).* • The accountant has identified, through their work, a control environment that is ineffective or not fit for purpose.

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			are documented to a standard that is commensurate with the size and complexity of the business.	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,***	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.	• 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	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	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	• 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 below.

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Rule 14, Rule 17, Rule 18, Rule 29, SRA Guidelines	Reporting structures within the firm should be such that accounts staff readily report errors and systems weaknesses to the COFA.	reports and matters reported in those, where appropriate. • Internal audit • Complaints by clients? • Review list of non-moving client account balances	Report (and any subsequent or additional work commissioned by the firm Also see points under 3.7 below.	issues included in the Accountant's Report (and any subsequent or additional work commissioned by the firm Also see points under 3.7 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	• 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	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	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)	• 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

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	include regular staff (finance **and** legal professionals) training, breach log review, exception reports.	reviewed by at least the COFA or another appropriate individual). • Where reconciling items appear on two 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.	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 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.	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 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	the firm, performs ad-hoc and/or informal 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. No challenge or action is taken by the COFA. • The same reconciling item (other than un-presented

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			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, there should be evidence of reporting to and review by the COFA.	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 by the COFA.	cheques) appears on two consecutive monthly bank reconciliations without clear evidence that it has been challenged by the COFA • The COFA, or another appropriate 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.

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					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 2.3***	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 business – evidence should exist of law firm's timely investigation	• 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 have been kept up to date under the appropriate timeframes. • Consider if the firm is able to, quickly and easily,	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. The law firm would be able to account to clients for client	• 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 accounting system that is commensurate with the size and complexity of the business and, as a consequence,

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	and follow up of such items.	account to clients for money held on their behalf.		money held.	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 has complied with the Rules.	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
3.9	Where suspense	• Identify if	Where suspense	Where a suspense	• Widespread

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Suspense ledgers Have you seen evidence of inappropriate use of a client suspense account? ***Rule 29.25***	accounts are used, this should be for temporary items only such as an unidentified receipt or payment.	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.	accounts are used, items are usually no more than 5 working days old.	account is used, items are usually no more than 30 working days old.	unjustified use of suspense accounts. • No process for clearing suspense accounts or outstanding items not followed up.

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AR1

Accountant's Report Form

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)		Firm SRA no	

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during the reporting period			
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 If **'yes'** please set out the details on a separate sheet of paper if necessary	Yes ☐	No ☐

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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 ☐

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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.

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Accountants reports - Impact Statement

1. This impact statement comprises an assessment of the reforms to the SRA Accounts Rules 2011 ('the Accounts Rules') in relation to accountant's reports against our regulatory objectives, as also considered in light of our public sector equality duty and the better regulation principles.

Protecting and promoting the public interest

2. 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 access to services. The policy will meet this objective by focusing accountant's reports on risks to client's money, rather than on technical breaches of the Accounts Rules.

Supporting the constitutional principle of the rule of law

3. We do not consider that these reforms will have a significant impact on this principle.

Improving access to justice

4. Whilst individually reducing or removing the costs to firms of accounting reports will have a limited effect, these reforms 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.

Protecting and promoting the consumer interest

5. 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.

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

7. 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.[20]

8. 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.

9. 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[21].

10. First we looked at matters received narrowly connected with accountant's reports. This incorporated breaches of Accounts Rules including items such as improper use of a suspense ledger, no accounting records, wrongful transfer of costs and unjustified client account shortages.

11. 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.

12. 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.

13. 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.

14. 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.

15. 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%.

16. 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.

[20] See Rule 35.1

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

17. 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.

18. 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.

19. 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.

Promoting competition in the provision of services provided by authorised persons

20. 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.

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

22. 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.

23. 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.

24. 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.

25. 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.

Encouraging an independent, strong, diverse and effective legal profession

26. 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.

27. These changes will particularly benefit smaller firms – of the 1014 firms identified in our analysis[22] 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.[23]

28. 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.

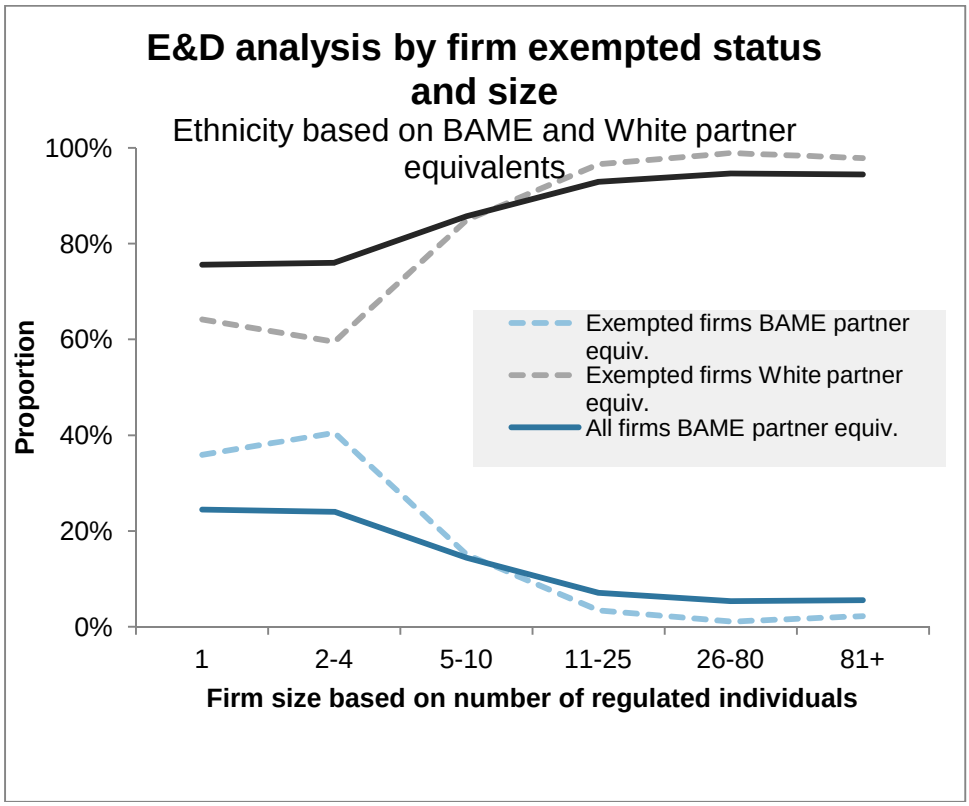
[22] Based on a wider dataset of firms comprising all firms in 2014 PCRE who held client money

[23] Based on whether a firm is a sole practitioner or has four or less partners AND has turnover under £400,000

29. **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

30. 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.



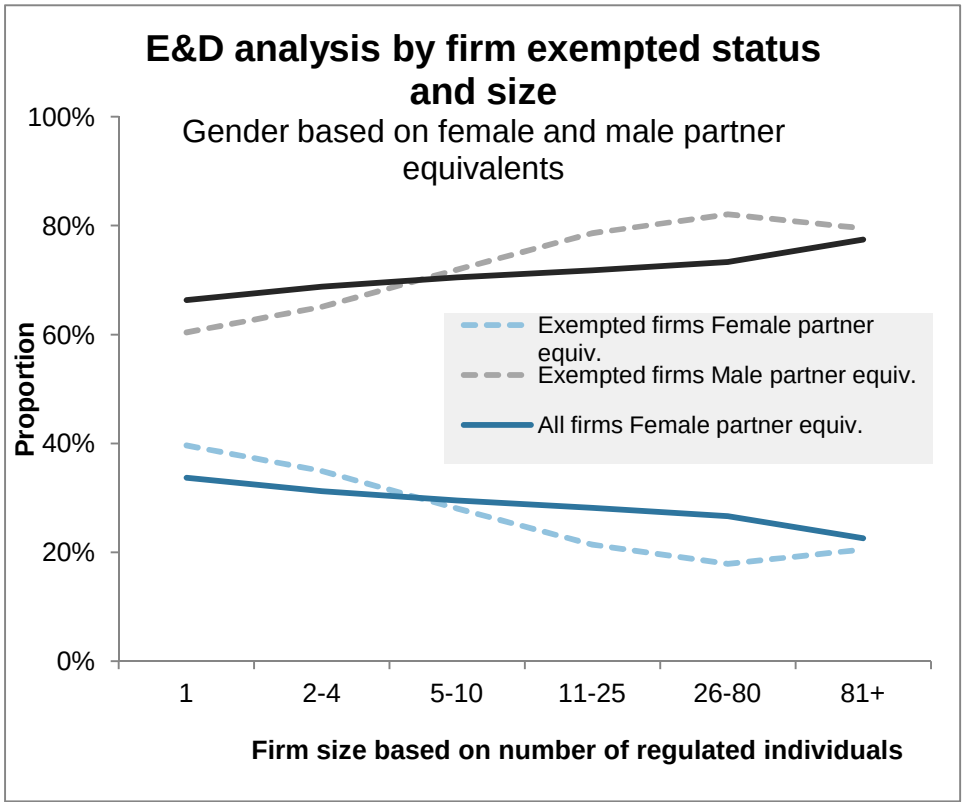
31. After taking unknowns out of the equation, we can see how size of firm is a factor affecting the ethnicity of individuals who work within exempted firms. However it also suggests that in the smallest (by number of regulated individuals) exempted firms BAME partner equivalents are more highly represented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

32. 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

33. 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.

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



35. 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.

36. 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.

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

Increasing public understanding of citizens' legal rights and duties

38. 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

39. 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.

The better regulation principles: proportionality, accountability, consistency, transparency and targeted.

40. We believe that these measures support the following better regulation principles in particular:

41. *Proportionate and targeted –by exempting lower risk firms from the requirement to obtain a report and focusing the accountant's reports and SRA resources in considering qualified reports on issues of risk to client money.*

42. The published guidance reduces any risk of reduced transparency or consistency that might otherwise flow from removing the current set testing requirements.