



Solicitors  
Regulation  
Authority

## **Consultation: Reporting Accountant**

Proportionate regulation: changes to reporting  
accounting requirements

May 2014

## Summary of our proposals

- **Remove the mandatory requirement that firms must have their client accounts reviewed by an independent accountant and submit an annual accountant's report to the SRA**
- **At the annual PC renewal stage, require COFAs to sign a declaration that they are satisfied that the firm is managing its client account in accordance with the SRA Accounts Rules**

These policy proposals are part of a programme of reforming initiatives designed to ensure that, while we continue to regulate in a way which protects consumers of legal services and supports the rule of law, what we require of individuals and firms is no more than is necessary, appropriate, and proportionate to meet these objectives.

It is our view that the cost to firms of engaging a reporting accountant, followed by the cost to the SRA in processing all annual accounts, can no longer be justified by the risks identified through this exercise. These policy proposals will reduce the unnecessary regulatory burden of a compulsory report and will give firms the flexibility to decide the best methods to satisfy themselves that the SRA requirements of good financial management and protection of client money are met.

In turn, the changes will enable the SRA to release resources and focus them on targeted regulation where we have concerns over a firm's management of client money. This will include the SRA imposing a requirement for an accountant's report where necessary either on an annual basis or as part of supervisory, investigative, or enforcement activity.

## Background

1. Each and every firm holding client money is currently required to submit an accountant's report to the SRA on an annual basis. This obligation, including detailed requirements for the style and content of the accountant's report, predates the introduction of the SRA Handbook in October 2011 and, in our view, is not best aligned with regulatory objectives as set out in the Legal Services Act 2007 or the better regulation principles.<sup>1</sup> In our view, the current prescriptive approach is neither sufficiently targeted nor proportionate. Because it is retrospective, sometimes by a considerable period, it adds cost with only limited benefits by way of consumer protection and overall management of the risk to client money. There is also some overlap with the COFA's recording and reporting function, thus this change presents an opportunity to clarify the scope of this role in terms of client money and, more broadly, financial accountability.

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<sup>1</sup> Five principles were identified by the Better Regulation Task Force in 1997 as the basic tests of whether any regulation is fit for purpose. *Proportionality* (Regulators should intervene only when necessary. Remedies should be appropriate to the risk posed, and costs identified and minimised.) *Accountability* (Regulators should be able to justify decisions and be subject to public scrutiny.) *Consistency* (Government rules and standards must be joined up and implemented fairly.) *Transparency* (Regulators should be open, and keep regulations simple and user-friendly.) *Targeting* (Regulation should be focused on the problem and minimise side effects.)

2. We also acknowledge that there is a wider issue regarding the handling of client money and the prescriptive nature of the SRA Accounts Rules (the Rules). These may not satisfactorily or optimally support the requirement to meet desired outcomes and manage risks appropriately. We are embarking on a more general review of the Rules in the coming months to ensure that they are fit for our regulatory purposes. Our proposals in this consultation are narrow, but we are also interested in wider views about holding client money and the construction and operation of the SRA Accounts Rules.

### How should the risks associated with holding client money be managed?

3. Around 9,000 law firms hold client money and this triggers the need for them to comply with the reporting requirements in the Rules. This includes the requirement that the firm must hire a reporting accountant who produces a form of report which is prescribed by the SRA and is designed to assess compliance with very detailed requirements against a series of checklist questions.
4. We understand the cost to the firm of meeting the existing mandatory reporting requirements varies depending on the number of transactions and scale of each client account. 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.
5. The SRA receives almost 9,000 reports annually and over 50% of them are qualified. Qualification may occur for a range of reasons from minor breaches through to more significant problems. Minor breaches may include short delays in posting money to the client account, wrongly posting a payment that is subsequently corrected, or an amount being wrongly allocated between office and client account. From the total number of reports received, about 200 are referred for further examination after internal processing and risk assessment, and usually only about 10 result in a referral to supervision for further investigation. Additionally, the SRA also stores hard copies of the last 6 years of reports. We estimate that processing, assessing, storing, and ultimately destroying accountants' reports costs the SRA as much as £200,000 a year.
6. Furthermore, accountants' assessments and therefore reports to the SRA are historic in their nature as they are completed at the end of an accounting year and submitted within six months of the year-end. This means that each report is dealing with transactions that are 6 to 18 months old. We do recognise that reporting accountants are required "immediately" to report evidence of fraud or theft or other issues of material significance as to whether a regulated person is fit to hold client money. However, through our reporting requirements for COFA and COLP, we also expect that material breaches<sup>2</sup> or serious misconduct<sup>3</sup> are notified as soon as reasonably practicable. Thus there is a potential duplication between the duties of the compliance officers and the reporting accountant.

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<sup>2</sup> Rule 8.5 SRA Authorisation Rules 2011

<sup>3</sup> Outcome (10.4) SRA Code of Conduct 2011

7. We do recognise that an awareness of the need for an independent review of client account and the overall discipline of producing an accountant's report may provide both a deterrent and a mechanism by which breaches are identified, thus modifying behaviour and mitigating risks.
8. Given the cost to firms in complying with the reporting accountant requirements and to the SRA in processing these reports, we do not consider the current approach provides enough benefits to justify its retention as a blanket requirement.

**Proposal 1** - We propose the removal of the mandatory requirement that firms must provide an annual accountant's report to the SRA.

9. Our proposal applies to all SRA regulated firms, those which operate in England and Wales, as well as overseas practices. Draft changes to the SRA Handbook reflecting this proposal are attached in **Annex 1**. In addition, consequential changes in other parts of the SRA Handbook where these reports are referred to may be needed. These will be considered together with changes proposed by in Annex 1 by the SRA Board when making the final decision.
10. While we propose to remove that compulsory requirement, we do continue to require firms to maintain proper standards of compliance and management of client money. Responsibility for these matters has always quite rightly rested with the firm and its managers<sup>4</sup> and not with the accountant preparing a report. The firm's COFA also has important, related responsibilities that need to be considered.
11. Rule 8.5 of the SRA Authorisation Rules 2011 requires all authorised bodies to have suitable arrangements in place to ensure that its compliance officers are able to discharge their duties. COFAs are required to take all reasonable steps to:
  - ensure that the authorised body, its employees and managers, comply with any obligations imposed under the SRA Accounts Rules;
  - keep a record of any failure to comply and make this record available to the SRA;
  - report any material failure (either taken on its own or as part of a pattern of failures) to the SRA as soon as reasonably practicable. Licensed bodies (ABS firms) must also report non-material breaches in accordance with the Legal Services Act 2007.
12. The COFA's duties relate to compliance by the law firm, its managers, and its employees with the SRA Accounts Rules. There clearly is an overlap with the SRA Accounts Rules requirement of compliance "*...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...*"<sup>5</sup>. COFAs will be unable to effectively fulfil their duties without access to financial management information, and in order to ensure compliance with Rule 1.2 of the SRA Accounts Rules, COFAs will need to consider whether they are able to access information on the practice's overall financial status and be in a position to make an assessment of that status.

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<sup>4</sup> See for example Rule 8.2 SRA Authorisation Rules 2011 and Outcome (7.4) SRA Code of Conduct 2011.

<sup>5</sup> Rule 1.2 of the SRA Accounts Rules

13. It is our assessment that the current requirements set out above, put a clear responsibility on the COFA to ensure the client account is managed and protected in accordance with the SRA Account Rules. The COFA must ensure the firm has systems and controls in place to enable the firm, along with all its managers and employees, to comply with the requirements on them.
14. We do acknowledge that firms developed their management systems and appointed current COFAs when an independent accountant report was required. However with the removal of the requirement to submit annual accountant reports, we consider that it is appropriate for the firm's COFA to declare that the firm's accounts are compliant with the SRA Accounts Rules with effect from the date of implementation of these proposals.

**Proposal 2** – We propose that, at the annual PC renewal stage, COFAs will be required to sign a declaration that they are satisfied that the firm is managing its client account in accordance with the SRA Accounts Rules.

15. Both proposals are planned for implementation in October 2014, subject to the consultation's outcome. This means that we do not expect that firms whose reports are due after October will need to submit them. At the same time, the PC renewal process will include a declaration from the COFA.

### What powers can be deployed to ensure targeted regulation and appropriate client protection?

16. The misuse of client money is one of the key risks to consumer protection and the achievement of regulatory objectives. Monitoring this risk effectively is therefore a regulatory priority.
17. There are risks involved in removing the requirement for accountant's reports which need to be clearly identified and managed:
  - potential deterrence of dishonesty, as firms know that there will be an external assessment of compliance;
  - potential deterrence or discovery of disorganisation and lack of appropriate systems of control and governance.
18. The SRA will lose a source of intelligence coming from accountants who treat their duties of reporting to us seriously. In addition, firms, will lose regulatory and compliance advice provided by accountants on an annual basis if they decide not to continue with external assessment.
19. However, the reality is that the risks in relation to client money will not be the same for all firms and in all sectors. In order to take a more targeted approach, we will need to ensure we are able to identify these areas and firms of concern and engage with them in a measured way. We will use all our current data sources, as well as our engagement with COFAs, to identify these areas and

respond appropriately with either supervisory action or enforcement tools which are appropriate and proportionate where necessary.

20. We propose to deploy a variety of approaches to mitigate the risk of financial impropriety, such as:
- A condition , on an authorisation or practicing certificate, if certain risk circumstances are present, requiring an accountant's report for a period and in a form stipulated by us.
  - A condition requiring an accountant's report following problems with client money;
  - If we identify that a firm is getting into difficulty in dealing with types of work where there is risk to client money (such as conveyancing or probate), conditions may be imposed not only for the production of an accountant's report but, if necessary, to prevent the firm from practicing that form of work. Such conditions are already deployed where necessary.
21. We are proposing to remove the detailed provisions in the Accounts Rules that dictate the form an accountant's report will take when we require it. This will allow us to prescribe the format and issues that should be addressed on a case-by-case basis in accordance with the particular risks that have been identified.
22. Draft changes to the SRA Handbook reflecting this proposal are attached in **Annex 1**. Any consequential changes to other parts of the Handbook arising from terminology changes will be presented to the SRA Board with main recommendations following this consultation.

## Proposals

**Proposal 1 - We propose the removal of the mandatory requirement that firms must submit an annual accountant's report to the SRA**

**Proposal 2 – We propose that, at the annual PC renewal stage, COFAs will be required to sign a declaration that they are satisfied that the firm is managing its client account in accordance with the SRA Account Rules.**

## Impact of our proposals

23. Regulatory systems cannot be managed in ways that completely remove any possible risk. Imposing a blanket requirement for an accountant's report imposes extra costs on all firms regardless of these particular risks. Regulatory costs are likely to be reflected in the prices all consumers pay. An excessive burden of regulation overall can reduce competition, further impacting on consumers.
24. While, there are potential risks to consumers in removing the universal requirement for a report, as we have acknowledged, we believe that a more

targeted approach, including requiring reports in particular cases and the strengthening of the reporting duties of the COFA, is the best way to deal with those risks.

25. We will continue to require firms which hold client money to have systems, policies, and internal controls which provide protection to their clients and which are appropriate in the context of their business, clients, and type and value of work undertaken. Firms are already obliged to have systems in place to ensure financial governance and effective management of financial risk issues.
26. The advantages of removing the blanket compliance requirement to hire a reporting accountant and submit an annual report to us, and substituting this with a risk-based response, are clear in the sense of reducing the cost of regulation. Some firms may decide that it is appropriate to continue using the services of an external accountant to provide an independent review of their accounts and support the firm's compliance culture. However, they will now be able to do so in a format that suits their individual practice.
27. Overall we estimate therefore that the net effect of these changes will be positive on the profession and consumers.

### Consultation questions

1. Do you agree with the removal of the mandatory requirement that all firms holding client money must submit an annual accountant's report?
2. Do you agree with the proposed amendment to the role of the Compliance Officer for Finance and Administration?
3. Do you agree with the proposed changes to the SRA Account Rules (attached in Annex 1)?
4. Do you have (or are you aware of) any evidence, analysis, or views that will assist us in completing an impact assessment on these proposals?

### How to respond to this consultation

#### Online

Use our online consultation questionnaire—<https://forms.sra.org.uk/s3/consult-cofa>— to compose and submit your response. (You can save a partial response online and complete it later.)

#### Email

Please send your response to [consultation@sra.org.uk](mailto:consultation@sra.org.uk). You can download and attach a Consultation questionnaire.

Please ensure that

- you add the title "Reporting Accountant" in the subject field,
- you identify yourself and state on whose behalf you are responding (unless you are responding anonymously),
- you attach a completed About You form,
- you state clearly if you wish us to treat any part or aspect of your response as confidential.

If it is not possible to email your response, hard-copy responses may be sent instead to

Solicitors Regulation Authority  
Policy and Strategy Unit – Reporting Accountant  
The Cube  
199 Wharfside Street,  
Birmingham,  
B1 1RN

### **Deadline**

Please send your response by 18 June 2014.

### **Confidentiality**

A list of respondents and their responses may be published by the SRA after the closing date. Please express clearly if you do not wish your name and/or response to be published. Though we may not publish all individual responses, it is SRA policy to comply with all Freedom of Information requests.

## ANNEX 1 - Proposal to remove the role of the reporting accountant

We propose to amend the SRA Accounts Rules to reflect this change:

### 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)

ensure that the COFA facilitates, monitors and reports on compliance with these rules as required by the Handbook and in particular that material failures to comply with these rules are reported to the SRA as soon as reasonably practicable~~deliver annual accountant's reports as required by the rules.~~

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## Rule 32: Delivery of accountant's reports

- 32.1 The SRA may impose a condition requiring the delivery of an accountant's report by you under rule 9 of the SRA Authorisation Rules or regulation 7 of the SRA Practising Regulations. Subject to rule 32.2 below, accountant's reports shall be prepared and delivered in accordance with these rules. ~~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 deliver to the SRA an accountant's report for that accounting period 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.~~
- 32.2 A decision to impose a condition requiring the delivery of an accountant's report may specify, among other things, that Part 6 and rule 50 of these rules and appendices 4 and 5 to these rules shall apply with such additions and modifications as may be prescribed in that decision. ~~In addition the SRA may require the delivery of an accountant's report in circumstances other than those set out in rule 32.1 above if the SRA has reason to believe that it is in the public interest to do so.~~
- 32.3 Rules 33 to 45 make additional provisions which apply when a person is required to deliver an accountant's report under rule 32.1 above.

### ~~Guidance notes~~

~~(i)~~

~~Examples of situations under rule 32.2 include:~~

~~(a)~~

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

~~(b)~~

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

~~(c)~~

~~when your conduct gives the SRA reason to believe that it would be appropriate to require earlier delivery of a report (for instance three months after the end of the accounting period);~~

~~(d)~~

~~when your conduct gives the SRA reason to believe that it would be appropriate to require more frequent delivery of reports (for instance every six months);~~

~~(e)~~

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

~~(f)~~

~~when a condition on a solicitor's practising certificate requires earlier delivery of reports or the delivery of reports at more frequent intervals.~~

~~(ii)~~

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

~~(iii)~~

~~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.~~























