

Solicitors Accounts Rules: What Accountants Need to Know

Many accountants will act in the capacity of *Reporting Accountant* in order to prepare the accountants report and checklist for solicitor clients who operate client accounts. This report and checklist is submitted to the Solicitors Regulation Authority (SRA) no later than six months after the client's year-end.

In October 2011, the Solicitors Accounts Rules (SARs) were changed considerably to be more 'outcomes-focused'. Solicitors must get to grips with the new regime to ensure they are following their rules properly and reporting accountants must also be familiar with the rules in order that they can spot breaches of the rules and to enable them to prepare the accountants' report and checklist.

The SARs were previously published as part of Edition 1 of the Handbook issued by the SRA which came into effect on 6 October 2011, however they now form part of Edition 2 of the Handbook which was published, and came into effect on, 23 December 2011.

Outcomes-focused

The first thing solicitor clients and reporting accountants need to understand is what exactly 'outcomes-focused' entails. An outcomes-focused approach is a regulatory regime which focuses on the high level Principles and outcomes that drive the provision of services to clients. The SRA has defined what an outcomes-focused approach IS and what an outcomes-focused approach is NOT:

An outcomes-focused approach IS:

- ✓ Designed to enable you to put clients first, where this does not prejudice the public interest
- ✓ About achieving the right outcomes for clients
- ✓ Flexible
- ✓ A move away from the prescriptive rules wherever this is appropriate

An outcomes-focused approach is NOT:

- ✗ Light-touch regulation
- ✗ A tick-box approach to regulation
- ✗ A 'one-size-fits-all' approach to regulation

Principles

Reporting accountants need to be aware that their solicitor clients have high level Principles which are set out in the Handbook and apply to all aspects of practice. Whilst all Principles must be complied with by solicitors, the SRA have identified those Principles which are particularly relevant to the SARs. The SRA stipulates that a solicitor and a firm must:

- ✓ Protect client money and assets;
- ✓ Act with integrity;
- ✓ Behave in a way that maintains the trust the public places in the solicitor and in the provision of legal services;
- ✓ Comply with legal and regulatory obligations and deal with regulators and ombudsmen in an open, timely and co-operative manner; and

- ✓ Run the business or carry out a role in the business effectively and in accordance with proper governance and sound financial and risk management principles.

It is worth mentioning that the SARs now refer to *you* rather than the *solicitor*. This is to acknowledge the fact that the rules apply to all those who carry on work in a firm as well as to the firm itself.

When the firm applies the Principles above, the SRA have acknowledged that the desired outcomes 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.

The rules

The SARs themselves are split into eight parts with each part containing a number of rules. In total there are 53 Rules:

Part	Contains
Part 1 – General	Rules 1 to 12
Part 2 – Client money and operation of a client account	Rules 13 to 21
Part 3 – Interest	Rules 22 to 25
Part 4 – Accounting systems and records	Rules 26 to 30
Part 5 – Monitoring and investigation by the SRA	Rule 31
Part 6 – Delivery of accountants’ reports	Rules 32 to 46
Part 7 – Overseas practice	Rules 47 to 52
Part 8 – Transitional provisions	Rule 53

The new rules contain a considerable number of changes to the previous rules and some of the more notable changes are as follows:

Rule 1

The key principles place much more emphasis on the importance of proper governance and keeping clients’ money safe which the SRA acknowledge is the overarching aim of the SARs.

Rule 2(1)

Prior to the SARs 2011, all the guidance notes to the rules formed a mandatory part of the rules. In the October re-write, Rule 2.1 states that the guidance notes do not form part of the rules.

Rule 14

Rule 14.5 strictly prohibits solicitors from providing banking facilities for their clients through the client account. This is not a new introduction from the old rules, but it is an important prohibition to be aware of. This is because use of the client account as a banking facility may result in the loss of the exemption status under the Financial Services and Markets Act 2000 where there is no underlying transaction supporting the deposit. It could also have implications under Anti-Money Laundering Regulations under the Proceeds of Crime Act 2002.

Rule 21

Rule 21.1 now allows withdrawals from the client account to be signed electronically. However, this particular rule also places a responsibility on the practice to make sure that appropriate safeguards and controls are in place where authority for withdrawals from the client account are signed electronically.

Prior to the re-write Rule 23 outlined those people who could authorise a withdrawal from the client account. This has now been replaced by a more outcomes-focused approach within Rule 21 whereby firms will need to have appropriate systems and controls in place relating to withdrawals from a client account. Rule 21.2 also states that a non-manager owner or a non-employee owner of a licensed body is not an appropriate person to be a signatory on the client account and must not be permitted by the firm to act in this way.

Rule 22

Rule 22 requires a firm to account to its client for interest when it is 'fair and reasonable to do so'. Prior to the re-write of the rules there were materiality tables which assisted in the calculation of interest payments to the client, which are no longer in the new rules. The firm must have a written policy on the payment of interest and the terms of this 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 (Rule 22.3).

Rules 29 and 30

Rules 29 and 30 allow firms to obtain, and retain, electronic copies of bank statements as opposed to relying on paper statements. Rule 29.12 requires all client accounts (including separate designated client accounts) to be reconciled *at least* once every five weeks. Please note that previously separate designated client accounts only had to be reconciled at least once every 14 weeks – this no longer applies and such accounts must be reconciled every five weeks. In practice it is extremely common to reconcile such accounts monthly as part of a firm's normal month-end routine.

Matters affecting reporting accountants

There is no denying that the SARS are complex and breaches of the SARS can occur without the solicitor intending to breach the Rules (often breaches occur without the solicitor even realising there has been a breach).

Reporting accountant versus auditor

Reporting accountants do not act in the capacity of auditors. Many solicitor clients will refer to the work done in compiling the accountants report and checklist as an 'audit' – but it is not an audit in the context of a statutory audit. As a result, the reporting accountant is not

expressing an opinion on whether the client's accounts give a true and fair view and they are not expected to detect material weaknesses in the solicitor client's internal control environment.

Whilst the reporting accountant is not acting in the capacity of auditor, and thus does not do checks such as tests of control on a client's internal control system, the reporting accountant does have a duty to report to the SRA any substantial departures from the guidelines for accounting procedures and systems contained in Rule 26 despite Rule 41.1(e) not requiring the reporting accountant to make a detailed check on compliance with the guidelines for accounting procedures and systems.

Materiality

In the world of audit, the concept of materiality is a fundamental aspect. However when an accountant is acting in the capacity of reporting accountant for the solicitor client, there is no concept of materiality. The question that is at the forefront of the reporting accountant's work is '*Has there been a breach of the rules or not?*' to which the answer is either 'yes' or 'no'.

Duty of care

There is a duty of care owed by the reporting accountant to the SRA and the SRA has the power under Rule 34.3 to disqualify a reporting accountant from dealing with any accountants report. The SRA will do this in the following situations:

- The accountant has been found guilty by his or her professional body of professional misconduct or discreditable conduct; [Rule 34.3(a)] or
- The SRA is satisfied that the solicitor/firm has not complied with the rules in respect of matters which the accountant has negligently failed to specify in a report. [Rule 34.3(b)]

In situations where you are faced with disqualification by the SRA the SRA will take into account any representations made to them by the accountant and the accountant's professional body. However, if you are disqualified by the SRA from making an accountants' report you will receive written notice of disqualification from the SRA (in accordance with Rule 34.4) and the SRA may notify any law firms which are likely to be affected and may publish the name of the disqualified accountant in the Law Society's Gazette or other publications.

It is also worth mentioning that the guidance notes (guidance note (i)) in Rule 34 do acknowledge that it is not a breach of the rules if a solicitor client instructs an accountant to do the bookkeeping and act in the capacity of reporting accountant for the purposes of completing the accountants' report and checklist. However, where you do act for the solicitor client in both capacities you must disclose these circumstances in the accountants' report.

Common breaches

There are some common breaches of the rules that occur time and time again – some not at the solicitor client's fault, but a qualified report may still be necessary. These are some of the most common breaches that have been found:

× Amounts paid into the client account which are not permitted

For example, agreed fees which are placed directly into the client account. This is a breach of Rule 17.5 which requires all agreed fees (a fee which is fixed and evidenced in writing) to be paid into the office account.

Another common breach of the rules is where the bank credits interest directly into the general client account. Solicitors should ensure that their bank be instructed to pay such interest directly into the office account to avoid a breach of the rules.

× Unauthorised withdrawals from the client account

This can occur when the solicitor draws money against an uncleared cheque. If the cheque is returned because of insufficient funds, it follows that other clients' money will have been used to make the payment which is a breach of the rules. The guidance notes under Rule 20 suggest the firm instructs their bank or building society to charge all unpaid credits to either the solicitor's personal or the firm's office account.

× Overdrawn client accounts

Rule 20 prohibits client accounts becoming overdrawn, with the exception of the two circumstances outlined in Rule 20.9(a) and 20.9(b). If the firm withdraws money from the general client account on the expectation that an electronic payment is on its way from the client, but the electronic payment does not arrive, this means that other client money has been used in breach of the rules.

× Use of suspense accounts

Rule 29.25 does permit the use of suspense client ledger accounts but only if the solicitor/firm can justify their use. They should not be used on a regular basis. Rule 29.25 gives an example of when an unidentified receipt is received and time is needed to establish the nature of the payment or identity of the client.

× Failure to reconcile bank accounts on a timely basis

Rule 29.12 requires all client accounts be reconciled at least every five weeks. In every day practice it is common to reconcile such accounts at the end of the month under the normal month-end routine. However, a breach of Rule 29 will occur when the solicitor does not reconcile the client accounts at least every five weeks. If this is the case, the reporting accountant must also consider whether such a breach is also a substantial departure of the guidelines for accounting procedures and systems contained in Rule 26.

× Transfers from client to office account within the specified time period

Many firms received 'mixed receipts'. These are receipts which include client money and office money/out-of-scope money (out-of-scope money is money that falls outside the scope of SRA regulation). Rule 18.3 permits such receipts to be placed into a client account in its entirety but all office and/or out-of-scope money must be transferred out of the client account into the office account within 14 days of receipt. A breach of the rule occurs when this 14-day time span is exceeded.

Conclusion

The SARs have seen some very notable changes take place in the October re-write and it is important that reporting accountants are familiar with all the changes. This article has considered some of the more notable changes, together with some of the more familiar breaches. However, familiarity with the SARs is a pre-requisite for reporting accountants and solicitors.



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