THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

21 April 2008

Our ref: ICAEW Rep 50/08

Your ref:

Margaret Hope
Solicitors Regulation Authority
Berrington Close
Ipsley Court
Redditch
Worc B98 0TD

By email: LSA@sra.org.uk

Dear Ms Hope

CONSULTATION PAPER 4; CHANGES TO THE SOLICITORS' ACCOUNTS RULES 1998

The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the consultation paper *Changes to the Solicitors' Accounts Rules 1998* published by The Solicitors Regulation Authority in February 2008.

The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

General points

We support the SRA's efforts to identify the risk elements present in the management of clients' money and to take steps to safeguard clients' funds. Reporting accountants have an important part to play in this process. We are disappointed that we were not consulted on changes to the reporting accountants' obligations (contained in the Legal Services Act) because we believe that as a consequence there is a lack of clarity and some real practical challenges.

There is a real danger that reporting accountants will consider SAR work too burdensome, not wish to risk the possibility of liability and cease to be prepared to take on these appointments. The population of firms who could come under the SRA's jurisdiction is likely to increase with the new structures available in future. Thus it is important that the SRA continue to have a sufficient number of quality reporting accountants to meet this need.

Chartered Accountants' Hall
PO Box 433 Moorgate Place London EC2P 2BJ
www.icaew.com

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX DX 877 London/City

We believe that these deficiencies can be addressed by issuing detailed and practical guidance. Our views and potential solutions are set out later in this response.

Whilst we recognise that the SRA are not undertaking a wider review than is necessary to implement the Legal Services Act we do think that it is false economy to not take this opportunity to address other issues in relation to the Solicitors' Accounts Rules. For example the rules have not been updated to take account of technological advances and the use of electronic transfers/banking/computer systems.

Tripartite agreement for SAR work

In the past the Institute and Law Society have had detailed discussions regarding the use of tripartite agreements. Indeed following a meeting in 2004 the Institute provided a copy of Audit1/01 and a briefing paper on the benefit of such an agreement. The SRA may be aware that the Institute already has such tripartite arrangements in place with the Civil Aviation Authority and various Government departments/bodies.

We strongly feel that such agreements assist in clarifying roles and responsibilities, the purpose and format of the report, scope of work to be undertaken and to help ensure efficient and effective working between the parties. We urge you to work with us towards introducing an agreement of this nature to deal with Solicitors' Accounts Rules appointments. In our view the case for a tripartite arrangement is increased by the development of a variety of business structures, as services provided by ABS in future cross over a number of disciplines, especially if the SRA's plans to extend and build upon the role of reporting accountants in securing information and monitoring compliance more generally (see our response to Consultation paper 7; Our ref: ICAEW Rep 52/08) are pursued.

Solicitor's obligation/responsibility to comply with rules

Whilst we recognise that requiring firms to sign off on their compliance with rules will not be a guarantee of improved compliance we strongly recommend that there is a requirement inserted into rule 35 or 36 for a statement, comparable to that signed by directors of companies in the audit process, to be included in the Accountant's Report. Introducing such a requirement for firms presents little burden but would serve as a reminder of the seriousness of the obligations. This will be increasingly important as firms adopt Alternative Business Structures and embrace the permitted greater flexibility in ownership. We previously raised this issue with the Law Society at a meeting on 29 March 2004 and we also sent a letter to Julian Wildsmith on 14 April 2004 with a paper setting out the reasoning behind having such a declaration, the possible benefits to the Law Society and example wording.

We suggest a statement along the lines of "*I/this firm/this company/this LLP recognises that the firm is obliged to comply with the Solicitor's Accounts Rules and have brought to the attention of the reporting accountant all breaches of which I/this firm/this company/this LLP is aware "*.

We urge the SRA to take steps to increase recognised bodies' knowledge and awareness of strong internal controls and risk management, to move them towards best practice in relation to clients' money. For example introducing a register of breaches which have been discovered, including the nature of the breach, the date it occurred, the rule breached any corrective action taken and the date it was taken.

As with the Institute's Clients' Money Regulations (available from www.icaew.com/membershandbook) we strongly support a requirement that each principal is responsible for compliance with the rules. We would suggest inclusion of an obligation on the recognised body itself upon which regulatory/disciplinary action could be taken if necessary (the Institute is able to take disciplinary action against a firm for non-compliance).

Signing on client accounts and authorising withdrawals

Access to clients' money and the ability for individuals to authorise a withdrawal from funds held in clients' accounts represents a risk against which consumers and the public expect and deserve adequate safeguards.

The risk breaks down into two areas:

- the integrity of the individual cheque signatories, and
- an individual's knowledge of the SRA's clients' accounts rules and related restrictions on withdrawing funds.

The SRA will introduce testing for the suitability and character of non-lawyer managers (see our response to Consultation paper 1, Our ref: ICAEW rep 42/08). In our view whatever test the SRA introduce, once it has determined that a person is fit and proper to be a manager of a firm the level of integrity and trust worthiness must be assumed to be high and therefore the risk to consumers low.

Whilst knowledge of the rules relating to client's money can be assumed when referring to solicitor managers the same cannot be assumed in respect of non-solicitor managers. Barristers and other non-solicitor lawyers may not be aware of the details of the rules anymore than a non-lawyer manager would be. However knowledge of the rules and therefore compliance with them in our view must be considered by a firm in deciding which individual managers it wishes to designate as cheque signatories and is not a matter for the rules to prescribe.

We would not advocate restricting cheque signatories to Chartered Accountants and Chartered Certified Accountants as it is neither competitive nor in the interests of the firms and potentially introduces confusion and unnecessary complexity. Nor would we generally advocate creating categories of manager who are prohibited from acting as cheque signatories as this would introduce practical difficulties. For example banks may find it difficult to understand or recognise the difference between one non-lawyer manager and another or for reporting accountants to consider the ability of different individuals to authorise withdrawals.

We strongly recommend that the SRA permits all managers to act as cheque signatories but issues detailed guidance to firms which strengthens management of client accounts more generally and assists in creating a 'best practice' environment which recognises and manages risk. For example, guidance could highlight the

inherent weakness in having a sole signatory for a client account and the increased risk of fraud that can bring. This would be in the interests of the firms, the SRA, the banks and the reporting accountants without harming the public interest.

We would be happy to contribute to the development of practical guidance.

We also suggest that a useful addition to the guidance notes to rule 23, in the light of any wider potential cheque signatories would be reference to the obligation on cheque signatories to satisfy themselves as to the authority, purpose and legitimacy of any withdrawal from clients' money.

Accountant's report of fraud etc

We recognise the importance of the SRA being alerted to matters which will present a risk to clients' money held by a firm. We support the intentions behind amended reporting disclosures but have serious reservations on the practical challenges and implementation of the SRA's reporting rules.

The Legal Services Act brought into effect an amendment to section 34(9) of the Solicitors Act 1974 mandating the "immediate" report of fraud or theft of clients' monies or of information which is of material significance to the fit and proper status of a solicitor, discovered during the preparation of the accountant's report. Naturally we are disappointed that this amendment, which radically changes the reporting accountant's obligations in this area, was not discussed with the accounting profession before being introduced. As a result practical difficulties which could have been avoided may have been introduced. This is unfortunate but we believe the SRA can and should address the deficiencies through guidance.

<u>Reporting "immediately"</u>

The new wording requires *immediate* reporting. Hitherto reporting accountants were *encouraged* to report directly to the SRA in these two areas. *Encourage* enabled a degree of flexibility and judgement which is absent from a mandated report to be made *immediately*.

The new wording refers to matters "discovered during the course of preparing an accountant's report" which is in our view lacks clarity. It is unclear what should be done in relation to matters which might fall outside that wording. For example matters brought to the reporting accountant's attention, rather than discovered or other matters which are discovered other than whilst preparing the report.

<u>Fraud/theft</u>

We envisage potential difficulties and overly onerous reporting with little, if any, additional benefit. The SRA are likely to be inundated with reports made "just in case" to protect the reporting accountant (as was the case in the early days of the introduction of the anti-money laundering regime for NCIS [now SOCA]).

These practical difficulties arise from the absence of:

- materiality

- information on what constitutes evidence (eg, does and inadvertent breach with no obvious element of intent constitute evidence?) and guidance on the level/detail of information required to trigger a report
- consideration of any corrective action already taken
- consideration of whether there is harm to clients.

Previously the reporting accountants could exercise judgement as to when and what to report to the SRA. We are not aware that the SRA or the Law Society were concerned that significant fraud or theft was under reported as a result of reporting accountants exercising their judgement, which would have been reported as a result of a mandatory requirement.

In the experience of our members who act as reporting accountants, firms bring to their attention occurrences of fraud or theft perpetrated within a firm, of which the firm is aware, is taking action and where there has been no loss to the client. In such cases the firm will themselves, upon completion of internal investigations, make a report to the SRA.

Matters of material significance to fit and proper status

Fit and proper in the context of holding clients' money is not defined. Matters which would impact upon that status and the point at which such matters would be of "material significance" are equally not set out. Under the previous wording this was not a problem because the reporting accountant could exercise judgement and did not face a breach of the law, with the consequences that brings, if their judgement was found to be incorrect with the benefit of hindsight.

However now the law states that the reporting accountant "must" submit a report. It is therefore essential that they understand fully those matters of relevance to the fit and proper status of the solicitor and the point at which such matters would be considered to be "significant". Guidance is imperative if the SRA are to avoid reducing the number of accountants prepared to take on the role and/or considerable over reporting to guard against liability.

Solution

We strongly feel that clear guidance is necessary:

- to identify what in these circumstances constitutes "evidence" of fraud or theft and clarify the point at which sufficient information is held/comes to the accountant's attention which triggers the reporting requirement
- to clarify that information which is not "discovered" but rather is brought to the attention of the reporting accountant by the firm and which he is satisfied will be brought to the attention of the SRA in due course only needs to reported by him as soon as is practicable or as part of his solicitors' accounts report
- to clarify what the SRA considers to be of "material significance in determining whether a solicitor… is fit and proper"

Guidance should be drafted in cooperation with the member bodies identified in rule 37. In order to facilitate this development the Institute would be happy to contribute to drafting work.

Test procedures

We note the extension of the testing requirements in respect of indemnity insurance for private practice (requirement to check period of cover in respect of European lawyers). We urge the SRA to ensure that reporting accountants are aware of the new requirements and, if it has not already done so, suggest you write to the bodies named in rule 37.

Other proposed changes

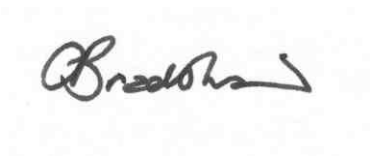
We welcome the simplification of the interest rules for "controlled trusts", making those rules consistent with the client money interest rules.

Whilst we welcome the change to rule 45 to reflect the position that privilege will not always attach to documents requested as part of the accountant's work, we note that this amendment has been driven by the admission of non-lawyer managers. We strongly believe that clear guidance should be given to solicitors and reporting accountants on the documents which may or may not be withheld from scrutiny.

Again the Institute would be willing to work with the SRA to develop appropriate guidance.

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely



Caron Bradshaw
Business Law Manager
Direct dial: 020 7920 8579
Email: caron.bradshaw@icaew.com