



CONSULTATION: ACCOUNTANTS RULES

PROPORTIONATE REGULATION: REPORTING ACCOUNTANT REQUIREMENTS

ICAEW welcomes the opportunity to comment on the consultation paper *Proportionate regulation: reporting accountant requirements* published by the Solicitors Regulation Authority on 18 November 2014, a copy of which is available from this [link](#).

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MAJOR POINTS

Supportive of a review of both the Accounts Rules and the accountant's report requirements

1. We welcome the fact that the SRA has sought to engage more widely in preparing this consultation and that it has taken on board some of the representations made in its first consultation in relation to the removal of the regulatory requirement for an accountant's report. We are supportive of an approach that provides more targeted and proportionate regulatory interventions and is underpinned by independent scrutiny. In this respect, we are, therefore, supportive of a wider review of the Accounts Rules and the accountant's report requirements.

The Accounts Rules must be reviewed and amended alongside changes to the accountant's report to achieve meaningful targeted and proportionate regulatory interventions

2. However, in our response to *Proportionate Regulation: Changes to Reporting Accounting Requirements* published by the Solicitors Regulation Authority (SRA) on 7 May 2014, we highlighted the need for, first and foremost, a radical overhaul of the Accounts Rules. As we said in our response, 'the Accounts Rules are not fit for purpose; they are inflexible and complex and our members continue to express concerns about their clients' lack of understanding of them. As a result, the current arrangements do not allow a cost effective and risk-based approach to be taken by our members to this work'. Despite this, the consultation focuses again on the accountant's responsibilities and report and the Accounts Rules, at this stage, remain unchanged. We believe that this looks at the issues from the wrong way around and as a result we do not believe that it will achieve the desired effect of a more targeted and risk based approach to client monies.
3. While a more risk-based approach for accountants, rather than a detailed checklist, would definitely be the right way to go - and we commend the SRA for considering this - it is difficult to say how accountants should report in advance of knowing what they should be reporting on, so the wider review of the Accounts Rules needs to be done in conjunction with the review of the reporting rules. This would then allow the SRA to firstly identify what it is concerned about – and what is material to it - and to then put in place a framework which would support this, alongside explanatory guidance to help accountants to report on this.

We would support a joint working group initiative to develop a suitable framework for the Accounts Rules and guidance for accountants reporting on it

4. We are fully supportive of the principles behind the proposed changes by the SRA to bring the Accounts Rules up to date but are acutely aware of the difficulty of making changes that also enable effective assurance. The assurance standards applied by auditors and accountants include a range of technical requirements with which we would not expect the SRA to be familiar. However, they do give rise to some important matters in relation to the SRA's proposals which would need resolution, such as the lack of risk factors and guidance, materiality and how it is to be interpreted, assurance of controls or end result or both and how professional judgement is exercised by accountants. These matters are covered in more detail below.
5. In citing these matters we wish to suggest the establishment of a joint working group between the SRA and ICAEW to discuss the nature of the SRA's requirements in order to help develop an end result that achieves the SRA's objectives to best effect. Recent experience with other regulators tells us that this is the most practical way to clarify needs with a view to ensuring that they are addressed in the best manner for the regulator. As an example, we have recently worked with the Pensions Regulator in developing assurance materials for Master Trusts.
6. Such a dialogue would revolve around ensuring that, whatever the SRA's needs may be, they are defined in a way that best enables accountants to deliver the right assurances in a cost effective manner to suit its needs. Such an exchange might involve:

- provision of background on assurance by the ICAEW;
- structured discussion around the SRA's needs and their definition;
- debate regarding the assurance options available that might be drawn from the portfolio available; and
- development of the resulting option including any related guidance notes and materials.

To apply their professional judgement, accountants require a clear framework that is supported by explanatory guidance

7. While we are supportive of accountants being able to use their professional judgement when carrying out this work, we do not believe that the SRA can expect accountants to start from a blank sheet of paper without a suitable framework which clearly sets out the SRA's risk factors or other supporting guidance. A framework will ensure that the work performed is consistent and appropriate across all accountants, and that it addresses the risks and concerns identified by the SRA as the priority risk areas.
8. An example where accountants use their professional judgement within a framework in this way is the performance of a statutory audit. Both the financial reporting framework and the Auditing Standards that must be adhered to when performing this work are set by an appropriate oversight body. In the UK, this is the Financial Reporting Council. Within the parameters of these, the accountant will use his or her professional judgement to determine the extent of testing required in order to give the opinion in the auditor's report.
9. Without similar guidance from the SRA it is questionable what assurance the SRA will obtain from the reports. For example the proposals do not include the concept of materiality when reporting breaches. While accountants can use their professional judgement to determine what they believe should be reported to the SRA, without guidance from the SRA on what constitutes a deficiency or clearly identified key risk factors the SRA cannot be confident that reports will include everything that they would want to be informed of. In addition if accountants err on the side of prudence and over-report matters, this will add considerable administrative burden to the SRA to determine what ones warrant any further action.

Need for greater clarity on the accountant's report opinion

10. We are supportive of the removal of the need to complete a detailed checklist and the removal of some of the detail on the accountant's report, including the names of partners from firms but the report itself does not contain an opinion that accountants would recognise as either a reasonable assurance opinion, a limited assurance opinion or some other form of recognised engagement such as agreed upon procedures. It therefore becomes unclear what assurance the SRA is actually getting from these reports.
11. We believe the SRA needs to reconsider what assurance it wants from accountants and to what extent this should be based on a test of controls or substantive testing.

Extension in timeframe

12. Given the issues we raise in this response we do not believe that an implementation date of April 2015 is achievable and would urge the SRA to reconsider this.

RESPONSES TO SPECIFIC QUESTIONS

Q1: 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?

13. We agree that the current Accounts Rules as they stand do not allow for the use of professional judgement by the accountant. We would be supportive of measures taken that would allow for our members to exercise their professional judgement but these need to be

within the boundaries of an appropriate framework for this work. We do not believe that the existing proposals include such a framework.

14. The SRA has sought to engage more widely in preparing this consultation and has taken on board some of the representations made in its first consultation in relation to the removal of the regulatory requirement for an accountant's report. We are supportive of this and an approach that would provide more targeted and proportionate regulatory interventions, underpinned by independent scrutiny.
15. However, the proposed changes are to the accountant's report only and do not tackle the complexity and prescriptive nature of the Accounts Rules themselves. As we explained in our response to *Proportionate Regulation: Changes to Reporting Accounting Requirements*, any proposals to change the accountant's report requirements must go hand in hand with a complete review of the Accounts Rules. We accept that the next phase of the SRA's work will look at the Accounts Rules but again believe this to address the issue the wrong way around. As a result, we do not believe that these proposals will achieve the desired objective of more targeted and risk-focused regulation that the SRA is looking for.
16. We are mindful of the challenges of making regulatory changes that also enable effective assurance. The assurance standards applied by auditors and accountants include a range of technical requirements with which we would not expect the SRA, or other regulators to be familiar. However, these technical requirements give rise to some important issues with the SRA's proposals which we believe would need to be resolved, such as
 - the lack of clearly identified risk factors;
 - lack of supporting guidance;
 - materiality and how it is to be interpreted;
 - assurance of controls or end result or both; and
 - how professional judgement is exercised by accountants.
17. We would encourage the SRA to consider establishing a joint working group of SRA and ICAEW representatives to discuss the nature of the SRA's requirements in order to help achieve its objectives to best effect. We have lots of experience with working with other regulators and we believe that this is the most practical way to clarify and address their needs. This could cover:
 - ICAEW providing background on assurance;
 - the SRA identifying and providing greater clarity on its needs and risk factors;
 - discussion of the assurance options available; and
 - development of the resulting option that the SRA might wish to take forward, including any related guidance notes and materials.
18. The proposals suggest that accountants should be able to use their professional judgement to design a programme of work and determine the nature and extent of testing but there is no reference to an appropriate framework or to any key risk factors clearly identified by the SRA. We believe that accountants require a clear framework, supported by explanatory guidance, to apply their professional judgement to determine the nature and extent of testing to perform. This is not the case in the current rules.
19. To more clearly explain the point here, we can take the statutory audit as an example. The reality is that auditors demonstrate professional judgement by applying applicable financial reporting standards while working within the boundaries of auditing standards (both of which, in the UK, are set by the Financial Reporting Council). In a similar vein, the SRA would need to provide a more clearly defined set of rules or principles, supported by guidance, which accountants can then exercise their professional judgement within, to determine the extent of testing needed.

- 20.** Currently, Rule 39 gives a detailed list of the checks and tests that accountants should perform when preparing their report. This means that the work performed by the accountant is comparable from report to report and the SRA can take comfort that the accountant has performed these checks as a minimum. As the new Rule 38 says that accountants can create their own work programme this is likely to lead to less certainty that certain checks have been completed and a lack of consistency in work being performed and in reporting.

Q2: 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?

- 21.** We believe that the SRA needs to reconsider the revised criteria for qualification. The SRA needs to be clearer in its own mind whether it wants a test of controls (i.e. operating effectiveness) or whether it is looking for more substantive sample testing. The consultation paper and accountant's report appears to confuse both approaches with references to controls and sample testing. Either the bullet wording in the accountant's report should be changed to directly demonstrate which rule it is that the SRA wants to be tested (i.e. detailed sampling) and a cross reference provided or the SRA needs to be clearer that it want controls to be tested (and therefore references to sample testing should be removed).
- 22.** If, as we believe, the SRA is more focused on ensuring that the firms have suitable systems of internal controls in place in relation to client monies, we believe that this needs to be clearer in the Rules and reflected in the accountant's report. We have previously developed a Technical Release, AAF 01/06 *Assurance reports on internal controls of service organisations made available to third parties* which might prove helpful here.
- 23.** In terms of the detail, the language in the Accounts Rules also needs to be consistent with the accountant's report. While paragraph 21 of the consultation paper says that the revisions to the rules ask the accountant to carry out work on a sample basis to ascertain whether the firm has maintained an effective client money accounting system which has enabled the firm to substantively comply with the rules, new Rule 38 refers only to checks and tests and does not mention work to be performed on a sample basis.
- 24.** The wording in the bullets in the report would also need to be tightened up. For example, how does the SRA define 'appropriate' in relation to the double entry accounting system? How is 'timely' and 'proper' defined in relation to maintenance of ledger entries and reconciliations? Some of these requirements are likely to lead to more work being performed than is currently required now.
- 25.** The new accountant's report form refers to 'deficiencies' in the firm's systems but paragraph 22 of the consultation paper refers to 'substantive deficiencies'. The phraseology needs to be consistent and the word 'substantive' also needs to be defined.
- 26.** The definition and explanation of trivial breaches has been removed from the Accounts. There is, therefore, a need for guidance on how to apply materiality and what materiality level should be set in order to ensure consistency of reporting and reports that meet the SRA's needs. This should provide guidance on what is meant by 'substantive deficiencies' and 'substantively complied with the Rules' in the accountant's report.
- 27.** Please also see our related answers to questions 1 and 3.

Q3: Do you have any specific comments on the proposed revisions to the format of the accountant's report in particular do you think:-

- That the wording covers the main areas accountants should be reporting on?
- That the level of detail we suggest is given by the accountant in the report if deficiencies are found is right?

28. Please see our related answers to questions 1 and 2 above. We are supportive of a slimmed down version of the report, without the need to complete a detailed checklist and the removal of references to the names of all the principals and the independence section but we are concerned about the proposed report opinion to be given by accountants.
29. The form of reporting needs to be recognisable but the proposed report does not contain an opinion that accountants would recognise as either a reasonable assurance opinion, a limited assurance opinion or some other form of recognised engagement such as agreed upon procedures. It therefore becomes unclear what assurance the SRA is actually getting from these reports. Removal of this ambiguity would benefit the SRA because it will have a more consistent basis on which to interpret reporting, therefore increasing the value to it.
30. The SRA may want to look at what other regulators are doing in this area. The FCA's Client Asset Sourcebook (CASS) rules have a framework for reporting (albeit one where all identified breaches are reportable) but it is helpfully supported by guidance produced by the Financial Reporting Council and an opinion that is in line with international standards on assurance. ICAEW has also produced guidance in relation to internal controls that might be relevant to the SRA's objectives.
31. We note that the SRA hasn't asked for values of client money held during the period, which seems appropriate as the balances are at a point of time and may be artificially high/low owing to client transactions at the time but it might be appropriate to ask for information on the nature of client monies held, the volume of transactions, the average client money balance during the period, and the highest balance held during the period to give them a flavour of firms who hold significant amounts of client money. This information could be provided, along with a declaration that a report has been prepared or confirmation of entitlement to exemption – see answer to question 7.
32. The space provided on the accountant's report for any matters in relation to deficiencies in the firm's systems or where the accountant has not been able to satisfy him/herself may not be sufficient for the level of detail that is needed here. Perhaps the report could include the possibility of including an appendix with this information.

Q4: Do you think that the revised approach will have an impact on fees charged by accountants to do the work?

33. Without a framework in place and guidance on the work to be performed, firms may face pressure to reduce their fees by the firms and this could result in too little work being performed.
34. In reality, however, without any supporting framework or guidance on how much work to do, the costs of this work could actually rise, particularly if accountants are being asked to design their own work programmes. A controls based approach (if this is what the SRA envisages with these proposals) may result in additional fees as many accountants might not have had to test controls previously.
35. If, as proposed, the SRA then intend to review the Accounts Rules next year, the cost of this work could rise again as the accountant revises or devises new work programmes to address the changes.

Q5: Do you consider that the revised approach will have any impact on attitudes to compliance by COFAs/the firms?

36. We believe that such an approach might result in inconsistencies in reporting and confusion which is likely to have a negative impact on attitudes of compliance by COFAs. A more coherent and structured set of requirements is needed here.

Q6: Do you think that the proposed changes should be supported by separate guidance to aid the accountants in the work they should be undertaking?

- 37.** Yes. Should the proposals be adopted as they stand, it is important that the SRA produce guidance on the procedures which should be undertaken and we would be keen to work with the SRA in this respect. If guidance is given by the SRA to confirm what test checks should be performed and which also highlights key risk factors, then firms may have a framework within which to design their own work programme.
- 38.** In the absence of any guidance from the SRA there will be an expectations gap and too much room for interpretation which could result in inconsistencies in the level of work performed and hence assurance provided.

Q7: 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.

- 39.** We believe that a declaration from the firm of compliance with its obligation to obtain a report and to submit it if qualified, would be helpful because it would help to reinforce the responsibilities of the firm in relation to compliance. It also provides a suitable mechanism by which the SRA can enforce compliance with the Rules as they may, from time to time, wish to see the unqualified reports to help ensure that the Rules are being adhered to. This statement of compliance could be coupled with information about the value and nature of client monies in the firm which would be useful to the SRA in assessing risks and in ensuring that those firms claiming exemption from the requirement to submit a report are entitled to do this. If the accountant submitted the report to the SRA rather than the firm, this would also help to address concerns that firms may either not be complying with the rules or not submitting qualified reports.

Q8: 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?

- 40.** We believe that the existing obligations are acceptable.

Q9: 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?

- 41.** Yes, we believe that the SRA should explore this option more fully. It is odd that it is the firms' responsibility to submit this report to the SRA but that they do not sign the report or take responsibility for it. Please see our response to question 7 above. We would recommend that the accountant submits the report to the SRA as is the case for reports to other regulators, such as CASS reports to the Financial Conduct Authority and ATOL accountants' reports to the Civil Aviation Authority.

Q 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?

- 42.** We would be supportive of proposals to introduce risk-based criteria that might exempt certain firms from the requirement to obtain and deliver an accountant's report where empirical evidence supports their low risk and where mechanisms were in place to ensure that the criteria were being adhered to – see our answer to question 7.

Q11: 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?

43. The SRA needs to ensure that the group in question is a low-risk group based on empirical evidence that shows that they are not well represented among non-compliant firms. Their exclusion should be based on a profile of firms who 'fail' or who misappropriate client funds. It is unclear whether this analysis has been done. 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.
44. Our members also suggest that some of the highest risks posed are from sole traders and smaller partnerships where trust monies or powers of attorney are held. The SRA should consider whether these and any other key risk factors should be factored into any criteria introduced.

Q12: 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?

45. We would suggest that the SRA focuses on identifying the key risk factors in relation to client monies and simplifies the Accounts Rules to give a more targeted approach in this area. We believe it would be helpful to carry out a thorough assessment of the underlying causes behind claims against PI insurance policies and the Compensation Fund as well as the SRA's interventions. This would help the SRA to identify key risks and to put in place a suitable framework that seeks to mitigate them.
46. Given the issues we raise in this response we do not believe that an implementation date of April 2015 is achievable and would urge the SRA to reconsider this.

Other comments

47. The SRA needs to check the references in the Rules. For example, in the new Rule 38, it refers to Rule 42 but we think this should be Rule 40.
48. The current qualification criteria for preparing an accountant's report are that you are a Chartered or Certified Accountant and an employee/member/partner of a registered auditor. This means that the Accounts Rules currently allow a tax partner (with no assurance experience) to perform the work required under the Accounts Rules and sign the accountant's report. The SRA may wish to consider if this is appropriate.
49. There are a number of typographical errors in the marked up changes of the Accounts Rules.