Autumn 2011

Legal Matters

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New SRA Accounts Rules – are you ready?

Although the introduction of Alternative Business Structures has been delayed pending Parliamentary approval, the launch of Outcomes Focused Regulation, and with it the new SRA Handbook, remains set for 6 October 2011.

Included within the Handbook are the new SRA Accounts Rules. Broadly unchanged from the current version of the Solicitors' Accounts Rules, the new rules have been updated to accommodate Multi-Disciplinary Practices and external ownership of legal practices (hence the removal of the word "Solicitors" from their title).

The key changes are set out below.

Out-of-scope money

Rule 2 introduces a new category of money, in addition to Office and Client money. 'Out-of-scope money' is defined as "money held or received by an MDP in relation to those activities for which it is not regulated by the SRA", in other words money directly relating to the provision of non-legal services by an MDP, e.g. estate agency services, IFA work, etc.

The rules go on to say that there is no requirement to include out-of-scope money in the client ledgers, and since the activities will not be regulated by the SRA, there is no need for dealings with out-of-scope money to comply with the new rules either. Practices will be permitted to hold out-of-scope money in their office and client accounts, but only temporarily.

Out-of-scope money is only going to be an issue for MDPs, who are probably going to need to have a completely separate set of ledgers (and quite possibly a completely separate accounts package) for recording transactions on non-regulated activities. From an Accounts Rules point of view, these firms will need to ensure that they are able to quickly establish whether monies held and received are office monies, client monies or out-of-scope monies, and

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deal with them accordingly. Where the firm acts for a client in a matter which includes activities regulated by the SRA, and also activities not regulated by the SRA, the rules only require that the transaction relating to the SRA-regulated activities are recorded.

Non SRA-regulated activities do not fall under the remit for Reporting Accountants, and as such, Reporting Accountants will not be required to carry out any specific testing on out-of-scope monies.

COFA

Rule 6 extends the responsibility for compliance with the Rules to the new Compliance Officer for Finance and Administration (COFA). The COFA can be a principal or employee, although they will need to be of sufficient seniority and in a position of sufficient responsibility to fulfil the role.

Under rule 8.5d of the SRA Authorisation Rules, the COFA will need to keep a record of any failure to comply with the Accounts Rules, and make this record available to the SRA. In addition, any material breaches of the Accounts Rules must be reported to the SRA as soon as reasonably practicable.

"Materiality" is a difficult concept, and one that is not defined anywhere in the Rules. Reporting Accountants have had to grapple with the concepts of 'material' and 'trivial' for years, as the SRA requires that any material breaches are listed on the Accountant's Report Form AR1.

To try to help, the guidance notes to the new Rule 44 state that "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. 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 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."

Client Accounts

Guidance note 6 to rule 13 requires practices to enter into a written agreement with all banks and building societies with whom they hold client monies, acknowledging that the account will hold client money, and that the bank or building society has no right to that money in relation to any liability of the practice.

Receipt and transfer of costs

Rule 17 replaces the current rule 19. A few of the current guidance notes have been moved into the main note, and the rule has been updated to cover out-of-scope money, but other than this the basic principles are unchanged.

Seemingly in response to a large number of questions from practices and accountants, rule 17 includes new guidance notes explaining when monies become "earmarked", and advising what to do if bills need to be agreed with clients before monies can be transferred from office to client account.

Withdrawals from client account

One of the most significant (and surprising) changes to the rules is contained in rule 21, which replaces the current rule 23. At present, withdrawals from a client account must be signed in advance by either a qualified solicitor, registered foreign lawyer, Fellow of the Institute of Legal Executives, a licenced conveyancer or a manager (partner / member / director) of the practice.

From 6 October 2011, the rules will allow authorities (and client account cheques) to be signed by "an appropriate person". The guidance notes state that "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 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."

Where firms have an outside investor, the rules do not allow them to be a signatory.

The rules also permit the use of electronic signatures, subject to appropriate safeguards and controls, e.g. passwords to prevent unauthorised access to someone's email or practice management software accounts.

We would strongly suggest that practices restrict the authorisation of client account withdrawals to partners / members / directors only. Certainly, we would advise against allowing accounts staff to sign client account cheques or approve electronic transfers without approval from a principal in the practice. It is easy to picture a scenario where a member of an accounts team transfers a few million pounds of client money to their own account and then disappears!

Where practices do decide to allow their accounts staff to approve client withdrawals, they should probably expect increased amounts of testing from their Reporting Accountant (and presumably increased fees too), since the inherent risk associated with their practice will increase substantially.

Interest

Another significant change to the rules relates to the payment of interest to clients. All of the detailed rules have been removed, and instead practices are required to have a written policy on the payment of interest, which seeks to provide a fair outcome for both the client and the practice. This policy must be shown to clients at the outset.

Interest must be paid "when it is fair and reasonable to do so in the circumstances". When deciding on the rates of interest to pay, firms must consider factors such as the amounts held and the periods they are held for, the need for instant access and the rates of interest payable on an instant access account at the bank or building society where the money is kept. The notes do however acknowledge that the amount of interest paid "is unlikely to be as high as that obtainable by the client depositing those funds."

The new rules also remove the distinction between the general client account and designated deposit accounts, so that firms can in theory make a turn on deposit monies too. However, the guidance notes state that firms will need to hold these monies in a general client account, so that interest can be paid into the office account.

In practice, we anticipate that many practices will adopt a policy broadly in line with the current rules, not only because it is easier, but because their practice management software will not allow a simple-to-administer alternative. Firms are also likely to stick with the current £20 de minimis, at least for now. With base rates at 0.5%, it will be difficult for firms to justify an increase to say £50.

It will also be difficult for firms to justify to existing clients why they have decided to go for a policy that pays less interest than they are paying now. Firms may therefore find themselves having to use different approaches for new and existing clients.

Now that the distinction between general client money and deposit money has gone, firms may be less inclined to open separate accounts for individual clients, although we have been recommending that they do not do this for many years.

Other changes

At present, where client monies are held in a passbook-operated separate designated deposit account they need only be reconciled every 14 weeks. From 6 October 2011, all client accounts will need to be reconciled at least every five weeks.

Finally, the new rules allow firms to obtain and save electronic bank statements each month, rather than having to obtain paper copies. This should make life much easier for many cashiers, although practices will need to be on the look out for any statements that appear to have been doctored by someone in their accounts department. We have seen several frauds concealed this way.

Summary

Any changes to existing rules are always a worry, but in reality the majority of the changes will have little impact, if any, on the way that most practices operate. Provided practices start thinking about the new rules now, and have new policies and procedures ready, then 6 October 2011 should hopefully not prove too much of a headache, at least from an Accounts Rules point of view!

For further information, please contact Andy Harris on 01242 237661 or email andrew.harris@hazlewoods.co.uk

HAZLEWOODS
DRIVING LIFELONG PROSPERITY

Windsor House Bayshill Road Cheltenham Gloucestershire GL50 3AT
Tel: 01242 237661 Fax: 01242 584263

www.hazlewoods.co.uk