The City of London Law Society

4 College Hill
London EC4R 2RB

Tel +44 (0)20 7329 2173
Fax +44 (0)20 7329 2190
DX 98936 - Cheapside 2

mail@citysolicitors.org.uk

www.citysolicitors.org.uk

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

18 June 2014

(By post and email: consultation@sra.org.uk)

Dear Sirs

Response of the CLLS Professional Rules and Regulation Committee to the SRA's consultation "Proportionate Regulation: changes to reporting accounting requirements" (the "Consultation")

The City of London Law Society ("CLLS") represents approximately 15,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its specialist committees. This response to the Consultation has been prepared by the CLLS Professional Rules and Regulation Committee.[1]

Before addressing the specific questions raised in the consultation we would question whether or not it is appropriate to make changes to the accountant's reporting requirements at this time, and separate from the general review of the SRA Accounts Rules ("the rules") which is about to be undertaken.

Paragraph 2 of the consultation paper acknowledges "that there are wider issues to be addressed" and that the current rules "may not satisfactorily or optimally support the requirement to meet desired outcomes and manage risk appropriately". We do not believe that any informed decision can be made about the accountant's reporting provisions in isolation from this wider review. We would go further to suggest that it is necessary to complete the review of the rules, and identify the key requirements and desired outcomes before any decision can be properly made on the assurance mechanisms required to support them.

Changing the reporting accountant's regime, whenever it is done, will inevitably be disruptive and incur cost for firms who will have to adapt to ensure compliance. Introducing a change now, ahead of the general review of the rules and absent any knowledge of the outturn of that

[1] A list of the members of the CLLS Professional Rules and Regulation Committee can be found here: http://www.citysolicitors.org.uk/index.php?option=com_content&view=category&id=151&Itemid=469

review, may mean that the change has to be revised or reversed at a later date adding to and duplicating the burden placed on firms.

For these reasons we think that this consultation is premature, and that no changes should be made to the current reporting accountant regime until such time as the general review of the rules has been completed.

Turning to the specific questions raised in the consultation:

Question 1: Do you agree with the removal of the mandatory requirement that all firms holding client money must submit an annual accountant's report?

There are two elements of this proposal: (1) the removal of the mandatory requirement that firms must have their accounts reviewed by an independent accountant, and (2) the removal of the mandatory requirement that all firms holding client money must submit an annual accountant's report.

We do not think that the argument and evidence presented in the consultation paper has made the case for (1), whilst the argument in favour of (2) is partially made. These two elements are conflated in the current proposal and, in this form, we cannot agree with it.

With reference to (1), paragraph 7 of the consultation paper recognises the positive benefits of a mandatory inspection as a deterrent, and its impact on behaviour and in mitigating risk. Paragraph 8 goes on to say that the SRA does not consider the current approach provides enough benefit to justify retention of the current requirements. Paragraph 1 says that it adds cost with only limited benefit by way of consumer protection and overall management of the risk to client money.

Is the SRA able to produce evidence to support these statements and, in particular, which proves that there is little or no correlation between the deterrent effect and behavioural impact of this mandatory requirement and the low level of reports referred for examination/to supervision for further investigation?

In the absence of any reliable evidence which shows that there is no correlation, we would not support withdrawal of mandatory accountant's inspection.

The practical experience of CLLS member firms' client accounting teams lead us to believe that the accountant's inspection is instrumental in encouraging compliant behaviour. We would also question whether this proposal would yield any cost saving for firms. Discussions with CLLS member firms indicate that the assurance provided by the accountant's inspection is valued, and the majority would continue to employ an independent accountant to undertake such an inspection irrespective of whether or not it was a mandatory requirement.

Concerns have been expressed that it is smaller firms, those with a less well developed infrastructure and control environment, who arguably obtain the most benefit from the discipline imposed by a mandatory inspection which are most likely to forego it if the prescription is removed.

Abuse of the client account is potentially the biggest single risk which consumers of legal services face and it therefore seems inappropriate to simply dispense with the mandatory requirements wholesale, not least because the SRA recognises that it does have positive benefits. We think it would be more appropriate to address the benefit/cost analysis by considering first whether changes to the scope of the inspection and form of the report would address its current failings, which supports our view that this proposal is premature.

With reference to (2), we note that of the 9,000 accountant's reports received by the SRA only 200 are referred to further examination and only some 10 of these are referred to supervision for further investigation. We accept that this does suggest that the submission of a full accountant's report to the SRA by every firm is not proportionate, and that there are cogent arguments for amending criteria which trigger the report to ensure that those received by the

SRA point towards real or possible threats to the regulatory objectives. However, we do not accept this as evidence that the accountant's inspection requirements which underpin the report are also unnecessary.

Is the SRA able to produce any evidence that the deterrent effect of the inspection is not a material contributor to the low levels of non-compliance identified and reported under the current regime?

As noted above, we would counsel against making any changes to the regime ahead of the general review of the rules. Notwithstanding this, some ideas on interim changes which could be considered are set out at the end of this letter.

Question 2: Do you agree with the proposed amendment to the role of the Compliance Officer for Finance and Administration?

We do not agree that, in the absence of an accountant's report, COFAs should be required to sign a declaration that they are satisfied that the firm is managing its client account in accordance with the rules.

Under the SRA Authorisation Rules, COFAs are already required to (i) ensure that the authorised body, its employees and managers comply with any obligations imposed under the SRA Accounts Rules; (ii) keep a record of any failure to comply and make this record available to the SRA; and (iii) report any material failure (either taken on its own or as part of a pattern of failures) to the SRA as soon as reasonably practical. Requiring the COFA to additionally provide a declaration that the firm is managing its client account in accordance with the rules would, depending on the form the declaration takes, either (i) result in the SRA receiving information it should already have received as material failure reports; or (ii) result in the same level of "qualified" declarations as there are currently qualified reports. We therefore do not see this requirement as being a useful or necessary one.

Question 3: Do you agree with the proposed changes to the SRA Accounts Rules (attached in Annex 1)?

We do not believe it is appropriate to amend the accountant's reporting requirements at this time and separate from the general review of the rules which is about to be undertaken. For this reason we do not agree with the proposed changes to the rules.

In the event that the SRA does decide to revise the accountant's reporting provisions now, and ahead of the general review of the rules, we would strongly counsel against the current proposal to withdraw them completely but would rather propose a more nuanced approach. Some ideas are set out below, and if you would like to discuss these further we would be happy to engage with you.

The mandatory accountant's inspection should be retained but could be refocused to concentrate on the fundamental provisions which protect clients. Say (simply to illustrate the point):

- Rule 1 - overarching objectives and underlying principles;
- Rule 14.1 - paying in client money without delay and holding such money in client account;
- Rule 20.1 - withdrawals from client account; and
- Rule 29 - accounting records for client account etc.

This approach should reduce the time and cost incurred in completing the inspection by relieving the accountant from having to audit and report incidental failures to comply with some of the more granular requirements of the rules; those which give rise to the majority of the qualified reports received by the SRA today but have only a marginal impact on the overarching

objectives and underlying principles. This reduction in scope might also facilitate a shortening of the timeframe within which reports must be submitted to the SRA.

As regards the accountant's report itself, clearly fraud, theft or other material evidence that a regulated person is unfit to hold client money would trigger an immediate obligation to report (as it does now). Beyond this, and in conjunction with reducing the scope of the inspection, the reporting accountant might be given more discretion to make a professional judgement as to what is reportable. The boundaries within which the accountant can exercise this discretion would need to be carefully drawn in consultation with the accountancy profession. The decision making criteria for the COLP and COFA when assessing the materiality of breaches, as set out in guidance note (x) in part 3 of the SRA Authorisation Rules, may present a template.

Under this type of regime the SRA would receive a much reduced number of qualified reports and only in respect of firms where there are, in the opinion of the reporting accountant, substantive issues. This has the potential to significantly reduce the cost and administrative burden for the SRA and would allow the regulator to focus resources where there are material risks. For all other firms the accountant could submit a "negative" return to confirm that no material or systematic issues had been identified.

Finally, we should note here that the time to respond to this consultation was short (just six weeks) and this was exacerbated by the fact that the SRA published four separate consultations on 7 May, each with an 18 June deadline. It has been a challenge to respond in time. For future consultations, we would prefer to have a 12 week period in which to respond - recommended as the norm in the Cabinet's Office's Consultation Principles Guidance.

Yours faithfully

Sarah de Gay
Chair, Professional Rules and Regulation Committee

© CITY OF LONDON LAW SOCIETY 2014
All rights reserved. This paper has been prepared as part of a consultation process. Its contents should not be taken as legal advice in relation to a particular situation or transaction.