

## Proportionate regulation: Changes to reporting accountant requirements

### Summary of consultation responses

#### Introduction

1. On 7 May 2014 we issued a consultation document seeking views on proposals to change the requirement to deliver annual accountant's reports. The proposals were designed to ensure that regulation is proportionate and targeted, with the aim of reducing costs for legal services providers and consumers.
2. The consultation closed on 18 June 2014. This report summarises the key points emerging from the responses, and the SRA's position as a consequence.
3. A summary by number of the answers to the questions posed is at Appendix 1. A breakdown of the composition of respondents and a list of those respondents who consent to their details being publicised is at Appendix 2.

#### Overview and next steps

4. The consultation included two proposals for changes to the SRA Handbook:
  - the removal of the mandatory requirement that firms must deliver an annual accountant's report to the SRA; and
  - a new obligation for COFAs to sign an annual declaration that they are satisfied that the firm is managing its client account in accordance with the SRA Accounts Rules 2011 (the Accounts Rules).
5. We received a total of 147 responses. We have been encouraged by the number and quality of the responses and are grateful for both the formal written responses we have received and the opportunity to engage with stakeholders at meetings and events during the consultation period. Respondents included the Law Society and local groups, a wide range of legal services providers, accountancy firms and their representative bodies, and an insurance company. Several of the accountancy firms acknowledged that they had commercial interest in the outcome of the consultation. There were no responses from consumers or their representatives.
6. Some respondents expressed clear reservations about the period of the consultation suggesting that it was too short to allow for a full exchange of views, because the consultation was issued at the same time as other consultation documents. While we acknowledge this concern, we are

reassured that there was widespread awareness of and engagement with the proposals, evidenced by their coverage by the media, the number and range of responses we have received, and our discussions with stakeholders. We are confident that we have had the opportunity to consider the full range of views.

7. There was broad support for the SRA's desire to move towards more proportionate and targeted regulation. Nevertheless, a majority of respondents disagreed with removing the annual requirement for an accountant's report – although many of those that did so felt that the format needed to be changed to make it fit for purpose. Many respondents agreed that the requirement to deliver accountants' reports places a financial burden on firms, although not all agreed that its removal should be considered separately from a full review of the Accounts Rules. Some respondents described the way in which they used accountants' reports within their firms, emphasising the value of having an element of independent scrutiny, and there were many references to reports being a powerful deterrent to non-compliance.
8. Although some respondents agreed with the proposal to require COFAs to make an annual declaration, the vast majority did not. There were strong views expressed about the additional burden that this would place on COFAs. Respondents identified the possibility that COFAs would commission accountants' reports in order to sign a declaration, and that the expected savings would therefore not materialise.
9. We have carefully considered all of the points raised in the consultation and remain of the view that the current universal requirement to obtain and deliver an accountant's report is not sufficiently proportionate or targeted. The strength of views raised in consultation regarding the risks presented by the removal of an annual requirement for all firms has led us to review our original proposals in light of our longer term plans to review the Accounts Rules as a whole.
10. It is no longer proposed that COFAs will be required to sign a declaration that they are satisfied that the firm is managing client account in accordance with the Accounts Rules.
11. We will be amending our original proposal to remove the mandatory requirement that all firms must deliver an annual accountant's report to the SRA. Instead we will:
  - (a) Introduce an amended version of the requirement for firms to obtain an accountant's report that exempts a small group of firms where the requirement can no longer be justified by the limited risks posed to client money; and
  - (b) Require all other firms to obtain an accountant's report but only qualified reports will need to be delivered to the SRA.
12. In response to the feedback received we have also made some straightforward amendments to the format of the accountant's report, removing unnecessary fields such as the requirement to provide a list of partner names (i.e. information already held by the SRA).

13. These proposals constitute "Phase One" of a longer-term strategy and will be implemented through amendments to the Accounts Rules to take effect from 31 October 2014, subject to approval by the Legal Services Board . This means that:
  - (a) any firms with an accounting period that ends before 31 October 2014 will need to prepare and deliver to us, in the normal way, an accountants' report within 6 months of the end of the period to which the report relates (or to apply for a waiver to do so, if considered necessary);
  - (b) any firms with an accounting period that ends on 31 October 2014 or after will be required to deliver only qualified reports within six months of the end of the period to which the report relates; and
  - (c) any firms that do only legal aid work and with an accounting period that ends on 31 October 2014 or after will not be required to obtain an accountant's report.
14. Phase two will involve further targeting of our requirements through the redefinition of the circumstances in which accountant's reports need to be qualified. The revised criteria and related amendments to the format of the report will be implemented through changes to the Accounts Rules in April 2015, subject to further consultation. We will also consider whether there are further categories of firms we can exclude from the requirement to obtain an accountant's report and consider the requirements imposed by the overseas accounts provisions of the Accounts Rules in light of the risks and impacts involved
15. The third and final phase will involve a major review of the Accounts Rules as a whole to be implemented through rule changes in April 2016.

## The responses

### ***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?***

16. The majority of respondents were opposed to this proposal, although there was a substantial minority in support. As indicated above, many who wanted to retain the reports felt that the current format was not fit for purpose.
17. The Law Society recognised that the requirement to deliver a report places a financial burden on firms, but said that it provides an important external review. Other respondents acknowledged that there would be savings to firms if the requirement were removed. However, a number of respondents disagreed with the proposal on the grounds that it would represent no cost saving to firms if COFAs were required to make a declaration of compliance at the same time, suggesting that a higher cost would be incurred in satisfying what was regarded as a more onerous obligation.
18. One respondent suggested that accountant's reports are "...historic and of little assistance, and an unnecessary burden for firms in both cost and time." In one of two responses, an accountancy firm identified some of the wider

benefits of reports, such as helping to identify staff training requirements, and their value to professional indemnity insurers and to future investors.

19. Another respondent suggested that: "Firms' managements quite often like the reassurance of knowing that someone else has looked at the systems and their operation. They like knowing that there is another pair of eyes that will be watching them."
20. The City of London Law Society distinguished between the obligations to commission a report and then deliver it to the SRA, suggesting that the two had been conflated in the consultation document and that the former could be maintained without the latter. With reference to the low number of reports referred for further regulatory action, it asked for evidence to demonstrate the extent to which reports act as a deterrent to non-compliance. Other respondents also suggested the reports were a deterrent, for example the Building Societies Association which said they were "...an essential anti-fraud measure, both as a deterrent and to detect any wrongful activity."

### **SRA response**

21. We have carefully considered these views and understand that they are relevant and important points, but are not persuaded that they amount to a case for maintaining the status quo. We acknowledge that there is limited evidence to support the proposal to remove the obligation. Equally, however, we consider that there is limited evidence to support the suggestion that they act as a deterrent to non-compliance. This is probably inevitable given the difficulty of identifying the drivers for compliance in the face of a range of different obligations.
22. The consultation document explained that around 9,000 firms hold client money and need to comply with the requirement in the Rules to deliver an annual accountant's report. It said that "From the total number of reports received, about 200 are referred for further examination after internal processing and risk assessment, and usually only about 10 result in a referral to supervision for further investigation". This statement requires clarification.
23. Almost half of the reports we receive are qualified and therefore risk-assessed in order to decide if further action is necessary. In fact, during the period from June 2012 to December 2013, 179 reports were referred for consideration of further action, mainly for the following reasons:
  - (a) a failure to undertake 5-weekly reconciliations or improper or incomplete accounting records;
  - (b) a failure to account to clients;
  - (c) office account issues - such as client money being improperly held in office account; and
  - (d) debit balances on client account.
24. Of these 179 reports, 38 do not yet have a decision or outcome as they are still being investigated. Of the remaining 141 reports assessed, over 90% resulted in no further action or were resolved informally, for example through

supervisory engagement or the issuing of a letter of advice. Eight resulted in regulatory or disciplinary action such as a fine or a referral to the Solicitors Disciplinary Tribunal (SDT). It is unclear from the data whether there were other factors involved in those cases that would have triggered regulatory action.

25. An analysis of our data shows that an additional five reports in the period referred to above contributed to varying extents to our decision to intervene into the firm concerned. In two of the matters, receipt of the qualified accountant's report led directly to the commission of an onsite investigation that formed the basis of the decision to intervene. In the other three cases, receipt of the qualified accountant's report was one of several pieces of intelligence or data that we held that resulted in an investigation and the intervention resolution. Each of these cases presented a high risk to consumers and in the absence of the accountant's reports it is possible, certainly in the two cases referred to, that we might not have been able to detect and act upon that risk. In the other cases, it is likely that we could have imposed a condition to require the delivery to us of an accountant's report because of the existing risk factors. In one recent intervention, it is interesting to note that we were alerted to very serious concerns about the handling of client money and unreplaced shortages in client account by the new bookkeeper who reported his concerns to us. He pointed out that the existing accountants had in fact submitted unqualified reports to us over the last several years and we found significant breaches of the Accounts Rules on the subsequent inspection. Overall, we accept that there will be a risk of loss of intelligence by the removal of the requirement as highlighted in these cases.
26. The culture of professionalism and compliance among solicitors and their firms provides a very solid starting point for compliance, and the severe consequences from being found not to be in compliance supports this. The fact that the SDT highlighted in their response to the consultation at least 25 cases in the 2013 where breaches of the Accounts Rules led to prosecution before the SDT (with many of those cases which involved deliberate misuse of client monies leading to a solicitor being removed from the roll) provides us with confidence that the sanctions available to us are such that some will be deterred from wrong doing.
27. We wholly agree with the SDT's comments in its response that the safeguarding of client's monies is sacrosanct. Nothing that we have proposed in the original consultation or in this response in any way affects or dilutes this requirement. Of the cases the SDT referred to, our data shows that only a small minority of the underlying investigations were triggered by receipt of the qualified accountant's reports. The significant majority of the investigations that led to the outcome at the SDT were triggered by other factors such as self reports or other pieces of intelligence. Five matters involved, amongst other allegations, a failure to deliver an accountant's report as required by the Accounts Rules. However, these matters generally resulted in a small fine being imposed by the SDT.
28. Of these five matters, we note that two cases related to a failure to deliver a 'cease to hold' report on closure, a requirement we now propose to retain. In one case, however, the investigation was triggered by an immediate report of

concerns by the firm's accountant that we accept we may not have received without the requirement.

29. We have therefore decided to implement an amended version of the original proposal whereby firms, with the exception of those that do only legal aid work, will continue to be required to obtain an annual accountant's report, although only qualified reports (under the existing criteria) will need to be delivered to us. We consider this to be a more proportionate approach to the existing universal requirement, which will also allow us to retain an important information source for a transitional period while we seek to redefine the criteria for qualification.

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

30. A small number of respondents agreed with this proposal. The Building Societies Association said "...it would be useful for the COFA to sign a declaration that they are satisfied that the firm is managing its client account in accordance with SRA Accounts rules. This seems like a sensible declaration."
31. Significantly more respondents disagreed. A number cited the relatively recent introduction of the role of COFAs and suggested that the proposal would amount to an onerous obligation on individuals which would lead to the perception that COFAs were solely responsible for a firm's compliance with the Accounts Rules. Asian Lawyers GB suggested that "Many lawyers would be put under pressure, by their employers, to make a declaration regardless of their views or understanding as to what they are declaring." One respondent thought that the obligation was unlikely to create a problem for small firms, but would be more difficult for COFAs in larger firms. Others suggested that the vast majority of COFAs would be unwilling to sign a declaration without obtaining independent verification. The Leicestershire Law Society suggested that the proposal might increase the risk of being unable to attract suitable candidates to act as COFAs. This view was echoed by an accountancy firm which said "We believe that this will place an unfair burden on COFAs many of whom we know first hand were appointed because there was 'no-one else' in the practice suitable or willing to carry on the role... "
32. Many respondents suggested that, if implemented, the proposal should be more clearly defined. For example the Law Society pointed out that given "...the high level of qualified accountants' reports, it seems likely that a significant number of COFAs will be unable to confirm that they have fully complied with the SARs over the year. It is unclear how the SRA will deal with reports of minor breaches and the cost implications of doing so."

**SRA response**

33. We believe that many of these points are well made and agree that the proposal might be disproportionate. We are particularly persuaded by the suggestion that it might lead to a perception that ensuring compliance with the Accounts Rules is the responsibility of the COFA alone and, as such, would be counterproductive. We are also conscious of the need not to elevate certain rules to a higher status through the use of declarations, and to avoid

the use of declarations as a bureaucratic comfort blanket for removing poorly targeted regulation. We have therefore decided not to pursue this proposal.

**Question 3: Do you agree with the proposed changes to the SRA Accounts Rules?**

34. Very few respondents commented in any great detail. There was some agreement that the proposed drafting would give effect to the proposed changes, but most respondents referred to their response to earlier questions, supporting or disagreeing with the proposals.

**Question 4: Do you have (or are you aware of) any evidence, analysis, or views that will assist us in completing an impact assessment on these proposals?**

35. 35 Most respondents did not provide a detailed response to this question. One commented that "...there is little evidence to dispute the assertion that where an industry is self-regulated....it leaves itself more open to abuse."
36. The Law Society expressed disappointment that "...this consultation has been published without any attempt at an impact assessment." It said it was particularly concerned about the impact of the proposals on those firms who are still required to deliver an accountant's report because it might be "viewed as a sanction by both clients and other stakeholders and may affect the firm's ability to join panels, obtain indemnity insurance and gain accreditation."
37. Several respondents answered this question by expressing their support for a wider review of the Accounts Rules and made suggestions of issues which could be considered as part of this review. We are grateful for these contributions and will ensure that they are addressed when the review commences.
38. Several respondents suggested that the experience of other regulators should be considered as a useful source of information, especially those which had both imposed and removed obligations for external oversight.

**SRA response**

39. An impact statement has been produced (insert link) and we consider that the revised proposals address the majority of concerns raised in response to this question.

## Respondents to the Consultation

Type of respondent	Responses
Law firms / solicitors	72
Individuals	4
Accountancy bodies	35
Local law societies	19
Representative groups, trade and membership associations	6
Insurance	1
Risk management	1
Other	9
<b>TOTAL</b>	<b>147</b>

This list includes only those who have agreed to their names appearing in a list of respondents.

### Law firms

A. L. Hughes & Co.

Access Law LLP

Alexander & Co. Solicitors LLP

ASB LAW LLP

Ashton KCJ

Bell Lax Ltd

Brethertons LLP

DAC Beachcroft LLP

Bennett Griffin LLP

Clifton Ingram LLP



Crowe Clark Whitehill LLP  
DJM Law Limited  
Davey Law Ltd  
David W Harris & Co  
Duchennes Solicitors  
Ellis Davies & Co.  
Frith and Co  
Hyland Fitzwater Solicitors  
Hughes Paddison  
Irwin Mitchell LLP  
Jacky Lewis Family Law  
Janes  
Keens Shay Keens MK LLP  
Kingsley Law Ltd  
LR Law Limited Lupton Fawcett LLP  
MDL Solicitors  
Mayfield Bell  
Minim Law Ltd  
NABARRO LLP  
Parrott & Coales LLP  
Stanley Jacobs Solicitor  
Tilly Bailey & Irvine LLP  
Warners Law LLP  
Winckworth Sherwood

**Accountancy firms**

D. A. Locke & Co, Chartered accountants  
Ballards Newman (Finchley) Limited

Quantum Accountancy Services Ltd

Armstrong Watson

Palmer McCarthy

Dendy Neville

Mercia Group Limited

Chartered Accountancy Practice

McBrides Accountants LLP

Franklin Underwood

Grant Thornton UK LLP

Hazlewoods LLP

Wilkins Kennedy LLP

Mazars

Harwood Hutton Limited

PWC

Baker Tilly

Goringe Accountants Ltd

Ryecroft Glenton

Deloitte LLP

Moore Stephens LLP

**Representative Groups, trade and membership bodies, professional bodies**

Asian Lawyers GB

Building Societies Association

Council of Mortgage Lenders

ICAEW

MHA Accountancy Network

Sole Practitioner Group

The Association of Accounting Technicians

The Law Society

UK 200 Group

### **Local Law Societies**

Birmingham Law Society

Cambridgeshire & District Law Society

Chester & North Wales Law Society

City of London Law Society

CWHLs

Devon & Somerset Law Society

Hertfordshire Law Society

Leeds Law Society

Leicestershire Law Society

Manchester Law Society

Middlesex Law Society

Newcastle upon Tyne Law Society

Northamptonshire Law Society

Nottinghamshire Law Society

Plymouth Law Society

Southend Law Society

Sunderland Law Society

Surrey Law Society

Tunbridge Wells, Tonbridge & District Law Society

### **Insurance firms**

Zurich Insurance plc