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Dear Sirs

Response of the CLLS Professional Rules and Regulation Committee to the SRA's consultation "Proportionate Regulation: reporting accountant 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 (see list of members attached).

Before addressing the specific questions raised in the consultation we would repeat the concern tabled in our response to the first SRA consultation paper on this subject. We question whether any informed decision can be made about assurance mechanisms in isolation from the general review of the holding of client money, or from the review of the Accounts Rules they are designed to support.

We note the minor changes to the accountants reporting requirements introduced on 31 October 2014 as "phase one" of this process of reform. These seem proportionate and sensible within the context of the current Accounts Rules regime. By way of contrast, the "phase two" proposals represent a major change in approach.

We do not question the validity of many arguments tabled in support of these proposals. Our concern is whether it is proportionate or necessary to tackle them now and separate from the wider review which will be undertaken in "phase three", and whether the benefits accruing from doing so adequately compensate for the disruption and risks it entails for both firms and the accountancy profession.

Turning to the specific questions raised in the consultation:

Question 1: 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?

The level of prescription in the current rules has often tended towards a standardised, "tick box", approach which does not necessarily address the specific risks to client money presented by any particular firm. We are broadly supportive of the proposal that this prescription should be removed.

We also support the proposal that the reporting accountant should have scope to exercise professional judgement, both to design an inspection programme around the specific risk profile of each firm, and in deciding what is a material threat to the safety of client money and thus requires reporting to the SRA. It is right that the SRA should feel able to place reliance on that professional judgement.

However, a possible risk is that some unscrupulous firms might put pressure on their accountants to structure the inspection in a particular way, whether to reduce costs or to effect a particular outcome. Whilst this is theoretically possible it seem unlikely, given that the accountant will be a regulated professional subject to a code of ethics and conduct.

Question 2: 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?

The elements identified and incorporated into Section Two of the draft Accountants Report Form (AR1) are undoubtedly an important part of any adequate client money accounting system.

We do not however believe that deficiencies in the system should be the sole criteria for qualifying a report. The accountant should also be required to report incidental failures in compliance which are considered, in his/her professional judgement, to be material to the safekeeping of client money.

We note that the accountant's current obligation to consider the SRA guidelines for accounting procedures and systems, contained in rule 40.1 of the Accounts Rules, has been removed in its entirety from the consultation draft. Whilst we do not believe that substantial departures should automatically be noted in the report as is currently the case, there is still value in the accountant having the guidelines as a benchmark of good practice and being aware of and obliged to consider them, given that they are incorporated into the systems operated by many law firms.

We strongly believe that rule 40.1 should be reinstated in this revised form:

"The accountant should be aware of the [SRA's](#) guidelines for accounting procedures and systems, and must consider any substantial departures from the guidelines discovered whilst carrying out work in preparation of the report"

We do not believe it is necessary or appropriate for the SRA to issue guidance to the accountancy profession on the sort of tests and checks it might expect the reporting accountant to undertake. Any such guidance would naturally acquire considerable authority, and may come to confine the accountant's discretion. If such guidance is necessary, this should be developed by the accountancy professional bodies for its members.

Question 3: 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?

Further to our answer to question 2, here is revised wording for paragraph 4 of section two of the accountants reporting form, which articulates the obligation to qualify the report for material instances of non-compliance.

4. We confirm that we are satisfied that the sampling we have undertaken has been adequate to enable us to confirm that the elements listed in section 3 above are incorporated in the firm's client money accounting systems and that the firm has substantively complied with the Rules.

OR

We found deficiencies in the firm's systems in the following elements and/or have identified material instances of failure to comply with the Rules and it has been therefore necessary to qualify this report.

If so, please describe in the space provided any matters in respect of which you have found deficiencies in the firm systems and/or material instances of failure to comply with the Rules. This includes any matters in respect of which you have been unable to satisfy yourself and the reasons for that inability

Subject to the small changes made to the text above, we believe that the level of detail you suggest is given in the report is right.

Question 4: Do you think that the revised approach will have an impact on fees charged by accountants to do the work?

Whilst this approach is likely to remove some unnecessary activities which are currently driven by the checklist, this will be counterbalanced by some additional work in assessing the risks presented by the client firm, and in planning the audit programme to effectively address the client's risk profile. On balance, we do not believe that the revised approach should have any material impact on fees charged, but the investment should produce a better report which is more relevant to the firm.

Question 5: Do you consider that the revised approach will have any impact on attitudes to compliance by COFAs/the firms?

As was highlighted in responses to the earlier consultation, we believe that the accountant's reporting regime is instrumental in encouraging compliant behaviour. In firms which are exempt from the accountant's inspection and reporting regime, it is possible that this revised approach might be seen as a relaxation of the rules which could negatively impact on the attitudes to compliance within those firms.

In firms which remain subject to the regime, it is unlikely to have any impact on attitudes to compliance.

Question 6: Do you think that the proposed changes should be supported by separate guidance to aid the accountants in the work they should be undertaking?

This question can only properly be answered by the accountants themselves.

If guidance is deemed necessary, this should be developed and issued by the accountancy professional bodies for its members. Time should be built into the implementation timetable to consult with the professional bodies on this point, and allow them time to produce the required guidance. See also our comments in the last paragraph of our answer to question 2 above.

Question 7: 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.

We recognise that there is a risk that firms might not comply, and under the new regime this may not be picked up by the SRA in a timely manner. We nevertheless question whether a declaration by the firm is going to flush out non-compliance, or that this is a proportionate response given that the majority of firms will comply and deliberately non-compliant firms will mis-declare.

We note that the SRA has recently obtained details of PI cover from relevant insurers, and raised queries with all those firms who did not appear to have cover. Consideration should be given to whether similar confirmations in connection with these inspection and reporting requirements could not be obtained directly from the accountants, given that the SRA has details of who is appointed for each firm.

Question 8: 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?

We do not believe that any tightening or enhancement to these existing obligations is necessary.

Question 9: 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?

There are strong arguments for requiring the reporting accountant to deliver reports directly to the SRA, arguments which are made more persuasive now that only qualified reports have to be submitted non-compliance will be less visible to the SRA.

This should be considered as part of phase three of these reforms.

Question 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?

In principle we agree with the proposal to exempt firms with a "low risk" profile from the accountants inspection and reporting regime. In practice, finding simple and meaningful criteria for identifying which firms are "low risk" is very difficult.

We are concerned that the amount of information the SRA would require to properly assess risk (see our answer to question 11), and the burden that supplying this information would impose on all firms is disproportionate to the benefit it is attempting to deliver.

Question 11: 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?

It should not be necessary to deliver an accountant's report in respect of some of the situations set out in paragraph 33 of the consultation. However, we think that attempting to apply criteria which focus on amounts is not the correct approach, assessing the risk to client monies is more complex. City law firms may have large amounts of money going through their client account but are more likely to have sophisticated systems designed to prevent risk to client monies. The risk to that money are not greater simply because the sums are large, notwithstanding the fact that any loss might have a higher impact. We also agree with your assessment that monitoring and applying criteria such as these would not be workable.

Whilst we appreciate why the average balance of client funds seems like a simple solution, we do not believe it, or any single measure, is alone an appropriate or reliable criteria for assessing risk, low or otherwise.

Taking firms with average balances less than or equal to £50k, as set out in paragraph 35, this balance is simply a snapshot at a particular point in time, and cannot alone speak to the risk any given firm represents. For example, one of these firms might hold £50k consistently month-on-

month, with little or no transactional activity between reporting dates. Another firm might have a £50k balance at month end (and at the end of each day), but have large sums and volumes of transactions passing in and out of client account daily by electronic means, which are undisclosed by the close of business balance.

In order to make an assessment of the relative and actual risk posed by these firms, the SRA would need to understand each firm's business model, type of practice, and its levels of transactional activity. These risks are likely to be better assessed and reported on by the reporting accountant, who will escalate issues identified to the SRA.

Question 12: 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?

The work undertaken in rewriting the new Overseas Accounts Rules has delivered a radical departure from the old regime, resulting in a principles based approach with little prescription in the form of detailed rules.

Whilst recognising that more detailed rules are likely to be necessary in the English domestic rules, and that accounting staff find some of the prescription useful, we would nevertheless be supportive of any initiative to simplify the SRA Accounts Rules and put them into a more logical order.

With this in mind, it is not useful to pick out specific areas or issues for consideration or piecemeal reform.

Professional Rules & Regulation Committee

Individuals and firms represented on this Committee are as follows:

Sarah de Gay (Slaughter and May) (Chairman)

Tracey Butcher (Mayer Brown International LLP)

Roger Butterworth (Bird & Bird LLP)

Raymond Cohen (Linklaters LLP)

Annette Fritze-Shanks (Allen & Overy LLP)

Antoinette Jucker (Pinsent Masons LLP)

Jonathan Kembery (Freshfields Bruckhaus Deringer LLP)

Heather McCallum (Consultant)

Douglas Nordlinger (Skadden Arps Slate Meagher & Flom UK LLP)

Mike Pretty (DLA Piper UK LLP)

Jo Riddick (Macfarlanes LLP)

Chris Vigrass (Ashurst LLP)

Clare Wilson (Herbert Smith Freehills LLP)