

SRA Reporting

The SRA Accounts Rules were amended in 2015 and apply to accounting periods ending on or after 1 November 2015. A year on from the commencement of the new reporting regime we look at some of the practical implications of the new rules for reporting accountants and draw on our experiences from some of the technical queries received in this specialist area.

Background

The latest version of the SRA Accounts Rules came into effect for accounting periods ending on or after 1 November 2015. The requirements are less prescriptive than for previous reports. In particular rule 39 in the previous accounts rules set out the detailed tests a reporting accountant was expected to carry out. This rule has now been deleted and replaced by rule 43 which places the responsibility for the nature and extent of the work to be carried out on the reporting accountant and requires that they use their professional judgment in determining the work required. In addition, the accountant's report form has been greatly simplified and completion of the reporting accountant's checklist is no longer required.

The guidance notes within the accounts rules identify a number of primary purposes for the report:

- to enable a proportionate degree of oversight by the SRA over risks to clients' funds;
- to help the firm identify any improvements in its control systems that are required;
- to provide assurance that client funds are properly safeguarded.

The SRA places increasing emphasis on a principles-based approach, which is apparent from rule 1 where the over-arching principle is that client money is kept safe and separate from that belonging to the solicitor, in a secure client account and only utilised on behalf of that client.

Considerations for reporting under the new rules

This more flexible, principles-based, approach can be problematic. Reporting accountants have been used to a prescriptive approach which set out exactly what was required of them. In the future they will need to use their own

judgement to identify the risks arising, bearing in mind the individual solicitors' client-base and the amount and types of client money held.

In addition to deciding on an appropriate programme of work to support the report, there may also be a critical decision to make on whether or not the report should be qualified. Unqualified reports are no longer required to be submitted to the SRA, which may well mean that solicitor firms are more inclined to question the decision to qualify the report, and the basis of that qualification, in order to avoid having to submit the report to the SRA. There is an element of fear amongst solicitors that a qualified accountant's report may result in a visit from the SRA or, at the very least, generate some kind of regulatory interest in their firm's affairs.



Help is at hand from the SRA in the form of **guidance** for reporting accountants. The guidance is useful and clearly states the SRA's view that a report should only be qualified where "...the breaches identified are material and likely to put client money at risk". The guidance introduces the concept of materiality to this type of assignment - not previously a term used in assessing compliance with the rules. It is clear

that the SRA does not expect trivial or non-material breaches to be reported in the form of a qualified accountant's report.

Section 2 of the guidance provides some useful illustrations of when circumstances might require an accountant's report to be qualified with examples of "serious factors" which are likely lead to a qualification and a separate list of "moderate factors" which may be material and require a qualification.



Section 3 of the guidance contains a table which, whilst not being a list of prescribed tests, does give a clear indication of what the SRA regards as very good, acceptable and

poor systems. Section 3.5 is worthy of particular note in that it directs the reporting

accountant to consider the work of the solicitor firm's Compliance Officer for Finance and Administration (COFA) and how effective that work is in terms of ensuring the integrity of the solicitor's accounting systems.

Mercia has received a number of technical queries on SRA reporting which hinge on the assessment of the seriousness of rule breaches found, rather than whether or not a breach has occurred. We often refer to the guidance on serious vs non-serious factors in discussing the potential impact of an issue on the accountant's report and considering where the breaches sit in terms of serious or moderate factors.

The reference to providing banking facilities through client account, under the serious factors heading in the guidance, has also raised some concerns. Rule 14.5 of the SRA Accounts Rules sets out the requirement that there must be an underlying legal retainer which justifies the holding of the funds and related transactions. For example, where a solicitor acts for a client on a number of matters it is acceptable to transfer funds held at the conclusion of one matter to that of another ongoing matter. What would be of concern are ledger transactions which are of no ongoing relevance to any work which the firm is carrying out. For example, banking services may be provided if a matter is concluded with funds due to a client who is overseas and does not have a UK bank account but instead asks the solicitor to hold onto the funds in order to pay certain UK expenses not related to the legal retainer.

Is the nature of this type of assignment now less risky?

The new reporting environment is less prescriptive and gives the reporting accountant discretion to decide whether or not an issue warrants a qualified accountant's report. It should be borne in mind, however, that the SRA states in its guidance that it relies on the reporting accountant's professional judgment. Consequently, this type of assignment should always be viewed as a higher risk. Quite often solicitor firms will be small organisations with simple accounting systems in which controls can be informal or easily by-passed but

Serious factors include:

1. A significant and/or un-replaced shortfall on the client account.
2. Wilful disregard for the safety of client funds, including overriding the requirements of the SRA Accounts Rules or guidelines.
3. Actual or suspected fraud or dishonesty by the managers or employees of the firm.
4. Material breaches not reported by the firm to the SRA in accordance with the SRA Authorisation rules.
5. Accounting records not maintained, or those records wholly inadequate.
6. Significant failure to provide information requested by the reporting accountant.
7. Three way client account reconciliations not carried out.
8. Client accounts used as a banking facility (rule 14.5).

Moderate factors include:

1. A significant, fully replaced, shortfall.
2. Actual or suspected fraud or dishonesty by third parties that may impact on the safety of client funds.
3. Material breaches that have not been reported to the SRA within one month of identification, in accordance with the Authorisation Rules.
4. Accounting records insufficient, unreliable or not retained for 6 years.
5. Three way client account bank reconciliations not regularly carried out at least every 5 weeks.
6. Poor control environment.
7. Inadequate performance or review of three way bank reconciliations.
8. Longstanding residual balances due to clients.
9. Improper use of suspense accounts.

which can hold significant sums of client money. Whilst much of the work previously undertaken under the old rules will still be relevant under the new rules, the work the reporting accountant will need to carry out should be risk-based, drawing on their professional experience in other areas, such as audit work. Mercia's updated specialist assignment manual addresses the requirements for reporting under the amended rules.

The future

The SRA has recently consulted on further proposed changes to its' accounts rules, with the clear direction of travel being towards additional simplification. Proposed changes include revising the definition of client money, so that certain monies will no longer be classed as client money and reducing the complexity of the rules themselves to further focus on key principles rather than prescriptive requirements. The SRA has also indicated an intention to consider the use of third party managed accounts (TPMAs) as a mechanism for managing transactions.

Important considerations going forward:

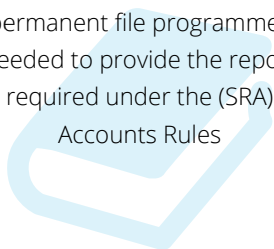
1. Principals and any staff allocated to this type of specialist assignment should be familiar with the reporting requirements currently in place.
2. All those involved in carrying out the assignment need to have a sufficient understanding of the solicitor's work and where the likely risk areas are. The work undertaken should be focussed primarily on those risk areas.
3. Accountants can no longer rely on the Solicitors Accounts checklist to indicate the work that needs to be carried out. Firms should consider using a proprietary programme to ensure that work is carried out effectively and that important areas are not overlooked. Work should include a review of the effectiveness of the solicitor's control procedures including the role of the COFA.
4. Accountants acting for solicitors need to watch for further developments affecting this area of work. The latest phase of the SRA's consultation has now closed and it is likely that there will be further amendments to the SRA Accounts Rules in future.



Mercia can help you assist your solicitors clients in a number of ways:

Solicitors' Accounts Rules Specialist Assignment Manual

Current and supplementary permanent file programmes needed to provide the report required under the (SRA) Accounts Rules



Specialist Courses

Various locations

Solicitors Accounts – An introduction to the SRA Accounts Rules

Solicitors Accounts – Practical problems with the SRA Accounts Rules

Solicitors Accounts Rules – Refresher/Update

Solicitors Conference

'Save the Date'

16 May 2017

To register your interest, email; felicity.beale@mercia-group.co.uk

