LEGAL HANDBOOKS

4th edition

# Solicitors and the Accounts Rules

## A COMPLIANCE HANDBOOK

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# Preface to the fourth edition

The Legal Services Act 2007 made significant changes to the way in which legal services are regulated and supplied in England and Wales. A large part of the Act came into force on 6 October 2011. From that date, alternative business structures (ABSs) were permitted to provide reserved legal activities as licensed bodies. The Solicitors Regulation Authority (SRA) as a licensing authority regulates traditional law firms (where all the managers and owners are solicitors or other lawyers) as authorised bodies (known as recognised bodies until 25 November 2019) and ABSs (where one or more managers/or owners are non-lawyers) as licensed bodies. The same SRA regulations apply to both authorised bodies and licensed bodies.

When those changes came into force on 6 October 2011 all the SRA's regulations were contained in the SRA Handbook, which included the SRA Code of Conduct 2011 and the SRA Accounts Rules 2011.

Following a lengthy consultation process significant changes were introduced to the regulation of the legal sector from 25 November 2019 and alongside this evolution of the SRA Handbook into what are now the SRA Standards and Regulations. These standards and regulations are founded on key principles and guidance rather than the mixture of prescriptive rules, outcomes and indicative behaviours of the previous regime. They include a Code of Conduct for Solicitors, RELs and RFLs and a Code of Conduct for Firms as well as the Accounts Rules. There is no 'one size fits all approach' and the Accounts Rules are considerably shorter than previous versions allowing firms a higher degree of flexibility while still achieving compliance.

This fourth edition will cover all these changes and the Accounts Rules in detail, as well as all the guidance issued by the SRA to the date of this publication. A couple of new chapters (**12** and **14**) provide practical tips for COFAs to help them meet their obligations and provide guidance for law firms in getting the best from their reporting accountants. In addition, we have added **Chapter 15** on VAT and costs covering the VAT treatment of fees and disbursements and **Chapter 16** dealing with trust corporations.

**Appendix A** provides the full text of the SRA Accounts Rules.

Many thanks to our colleague Rosie Finch for her contributions and to our VAT experts, Julie Towers, Becky Hayes and Mark Bishop, for providing Chapter 15 on VAT and costs.

# Abbreviations

| | |
|---|---|
| 2011 Rules | SRA Accounts Rules 2011 |
| ABS | alternative business structure |
| AML | anti-money laundering |
| CGS | Capital Goods Scheme |
| COFA | compliance officer for finance and administration |
| COLP | compliance officer for legal practice |
| FCA | Financial Conduct Authority |
| FSCS | Financial Services Compensation Scheme |
| FTT | First-tier Tribunal |
| GST | Goods and Services Tax |
| LAA | Legal Aid Agency |
| LLP | limited liability partnership |
| LPA | lasting power of attorney |
| MDP | multi-disciplinary practice |
| MRO | medical reporting organisation |
| PII | professional indemnity insurance |
| REL | registered European lawyer |
| RFL | registered foreign lawyer |
| RFP | request for payment |
| SDLT | stamp duty land tax |
| SDT | Solicitors Disciplinary Tribunal |
| SRA | Solicitors Regulation Authority |
| TPMA | third party managed account |
| TT | telegraphic transfer |
| VAT | value added tax |
| VATA 1994 | Value Added Tax Act 1994 |



CHAPTER 1

# The regulatory structure and SRA Accounts Rules

## 1.1 INTRODUCTION

The Solicitors Regulation Authority (SRA) Accounts Rules form part of the SRA Standards and Regulations which came into effect on 25 November 2019, replacing the SRA Handbook.

The SRA Accounts Rules were made by the SRA Board on 30 May 2018, under ss.32, 33A, 34 and 37 of the Solicitors Act 1974, s.9 of the Administration of Justice Act 1985, and s.83(5)(h) of, and para.20 of Sched.11 to, the Legal Services Act 2007. They replace the SRA Accounts Rules 2011 (the 2011 Rules).

The introduction to the SRA Accounts Rules outlines the overall requirements of the Rules for when firms (including sole practices) authorised by the SRA receive or deal with money belonging to clients, including trust and other money or money held on behalf of third parties. The Rules apply to all firms authorised and regulated by the SRA and this includes all those who manage or work within such firms.

## 1.2 WHO IS AUTHORISED AND REGULATED BY THE SRA?

The implementation of the Legal Services Act 2007 led, on 31 March 2009, to 'entity regulation', or firm-wide regulation, of the solicitors' profession. In addition to regulating individuals the SRA also regulates all firms, whether they are a sole practice, traditional partnership, limited liability partnership (LLP) or a company.

The SRA regulates those it has authorised to practise as:

- a recognised body – i.e. a partnership, an LLP or a company whose owners and managers are all lawyers. The SRA Glossary defines a lawyer as follows:

> **lawyer** means a member of one of the following professions, entitled to practise as such:
>
> (a) the profession of *solicitor*; *barrister* or advocate of the *UK*;
> (b) an *authorised person* other than one authorised by the *SRA*;

(c) any profession approved by the *SRA* for *RFL* status; and
(d) any other regulated legal profession specified by the *SRA* for the p... this definition

The definition at (b) would include legal executives, licensed conveyan... trademark and patent agents and costs draftsmen and notaries;

- a recognised sole practice; or
- a licensed body, i.e. one where there are non-lawyer managers or owners... known as an alternative business structure (ABS)).

Alongside this, the SRA regulates all managers and employees of recognised... licensed bodies and all employees of a recognised sole practice.

The Legal Services Act 2007, the SRA Accounts Rules and other profess... rules refer to 'managers'. Under the current provisions a manager is defined as...

- the sole principal in a recognised sole practice;
- a member of an LLP;
- a director of a company;
- a partner in a partnership; or
- in relation to any other body, a member of its governing body.

## 1.3 WHAT DOES THE SRA REGULATE?

The SRA regulates all firms and individuals that it has authorised in respect... provision by them of 'regulated services'. These are defined as the legal and ... professional services they provide that are regulated by the SRA. These in... acting as a trustee or as the holder of a specified office or appointment. All firms... provide the following services need to be authorised:

- reserved legal services for the public (unless exempt) (see **1.3.1**);
- immigration services, unless regulated by the Office of the Immigra... Services Commissioner (OISC);
- claims management services, unless regulated by the Financial Cond... Authority (FCA); or
- regulated financial services activities, unless regulated by the FCA.

Authorisation will be by the SRA or may, in certain circumstances, be by an... approved regulator.

### 1.3.1 Reserved legal activities

The Legal Services Act 2007, s.12 sets out six specific activities that are defin... 'reserved legal activities' and can only be undertaken by those who are auth... by an approved regulator (for our purposes the SRA), or are exempt from... requirement to be regulated. These activities are:





- the right to appear before and address a court, including the right to call and examine witnesses;
- the conduct of litigation – the issuing of proceedings, commencing, prosecuting and defending them;
- reserved instrument activities – essentially conveyancing;
- probate activities – preparing any probate papers on which to found (non-contentious) or oppose (contentious) a grant of probate or a grant of letters of administration;
- notarial activities – the authentication and certification of signatures and documents; and
- the administration of oaths – administering oaths or taking affidavits for court purposes.

### 1.3.2 Other legal activities

Although there can be grey areas essentially all other legal activities fall outside the regulatory framework of the Legal Services Act 2007, and are referred to as 'non-reserved'. These include:

- providing legal advice or assistance in connection with the application of the law or with any form of resolution of legal disputes;
- providing representation in connection with any matter concerning the application of the law or any form of resolution of legal disputes.

It is perhaps worth noting that any activity of a judicial or quasi-judicial nature, including acting as mediator in legal disputes, is not defined as legal activity at all.

While a firm that provides only non-reserved legal services (and does not do work under any of the other categories noted above, such as immigration work) does not need to be authorised it can choose to be, although certain criteria, such as the intention to deliver legal services, will apply. A firm may choose to be authorised by the SRA, for example, to provide reassurance to clients regarding the protections they will be afforded.

However, as noted at **1.3**, the SRA regulates its authorised firms in respect of all legal and other professional services provided by them. In short, although non-reserved legal activities fall outside the regulatory framework of the Legal Services Act 2007, the SRA does include these as part of its own regulatory framework where a firm is SRA authorised. In these cases (which are typical) both the reserved and non-reserved activities fall within the SRA Standards and Regulations.

## 1.4 SRA ACCOUNTS RULES

Part 1 of the SRA Accounts Rules explains whom the Rules apply to and how they are applied, namely:

- the Rules apply to all authorised bodies, their managers, and employees;
- the authorised body's managers are jointly and severally responsible for c
- compliance of the authorised body, its managers and employees; and
- for a licensed body, the Rules apply only in respect of activities regulated by th
SRA in accordance with the terms of its licence.

The SRA Accounts Rules apply to those recognised bodies and recognised sole practices that have been authorised by the SRA to practise – hence the term 'authorised bodies' (which includes licensed bodies).

Managers are directly responsible for their own conduct in relation to the SRA Accounts Rules even if they are non-solicitor lawyers or non-lawyers. All employees of a solicitor's practice are also directly responsible for their own compliance and again this will include non-solicitor lawyers (such as barristers) as well as non-lawyer fee earners, accounts staff and other support staff. Non-compliance by any manager or member of staff could lead to a disciplinary action against the firm itself and/or the individual.

Part 1 also makes it clear that any references to 'you' in the SRA Accounts Rules refer to the authorised body, its managers, and employees. In this handbook a reference to a 'solicitor', a 'firm' or a 'practice' is a reference to the term 'you' as defined above unless the context provides otherwise.

The SRA Accounts Rules are printed in full in **Appendix A**, and the Codes of Conduct are provided in **Appendices B** and **C**. The full Standards and Regulations can be accessed on the SRA's website: **www.sra.org.uk**.

## 1.5 SRA STANDARDS AND REGULATIONS

As mentioned in the introduction at **1.1**, the SRA Accounts Rules form part of the SRA Standards and Regulations, implemented on 25 November 2019.

The SRA has made the following comment on its website: 'Our shorter, simpler Standards and Regulations focus on high professional standards and protecting the public.'

As well as the SRA Accounts Rules themselves, there are a number of other aspects of these Standards and Regulations that are relevant to compliance with the SRA Accounts Rules. The key aspects include those set out in **1.6**, **1.7** and **1.8**.

## 1.6 SRA AUTHORISATION OF FIRMS RULES

Rule 8.1 of the SRA Authorisation of Firms Rules requires every firm to have, at all times, an individual who is designated as a Compliance Officer for Finance and Administration (COFA). The COFA must be approved by the SRA and be a manager or an employee of the firm. The COFA's responsibilities, as detailed in the SRA Code of Conduct for Firms, para.9.2, are to take all reasonable steps to





- ensure that the firm and its managers and employees comply with any obligations imposed upon them under the SRA Accounts Rules;
- ensure that a prompt report is made to the SRA of any facts or matters that the COFA reasonably believes are capable of amounting to a serious breach of the SRA Accounts Rules which apply to them;
- ensure that the SRA is informed promptly of any facts or matters that the COFA reasonably believes should be brought to the SRA's attention in order that it may investigate whether a serious breach of its regulatory arrangements has occurred or otherwise exercise its regulatory powers.

The existence of a COFA in a firm and the requirements for the COFA to ensure that the firm, its managers and employees are complying with the SRA Accounts Rules are not a substitute for the responsibilities of the firm and the managers and their own obligations to comply with the Rules.

## 1.7 SRA PRINCIPLES

The Principles set out in the Standards and Regulations apply to all aspects of a practice, including the handling of client money. Firms (and their managers and employees) must act:

- in a way that upholds the constitutional principle of the rule of law, and the proper administration of justice;
- in a way that upholds public trust and confidence in the solicitors' profession and in legal services provided by authorised persons;
- with independence;
- with honesty;
- with integrity;
- in a way that encourages equality, diversity and inclusion;
- in the best interests of each client.

## 1.8 SRA CODE OF CONDUCT FOR FIRMS AND SRA CODE OF CONDUCT FOR SOLICITORS, RELS AND RFLS

Both of these codes contain parts that should be considered in the context of overall SRA Accounts Rules compliance. Those that are perhaps most relevant are highlighted in **1.8.1** and **1.8.2** below.

### 1.8.1 Code of Conduct for Firms

Compliance and business systems (paras.2.2 to 2.4):

- 2.2 requires firms to keep and maintain records to demonstrate compliance with their obligations under the SRA's regulatory arrangements.
- 2.3 makes it clear that the firm remains accountable for compliance with the SRA's regulatory arrangements where its work is carried out through others including managers and those the firm employs or contracts with.
- 2.4 requires firms to actively monitor their financial stability and business viability. Once a firm is aware that it will cease to operate, it must effect an orderly wind-down of activities.

Client money and assets (paras.5.1 and 5.2):

- 5.1 requires firms properly to account to clients for any financial benefit received as a result of their instructions, except where they have agreed otherwise.
- 5.2 requires firms to safeguard money and assets entrusted to them by clients and others.

### 1.8.2 Code of Conduct for Solicitors, RELs and RFLs

Client money and assets (paras.4.1 to 4.3):

- These require of an individual that:

  4.1 You properly account to *clients* for any *financial benefit* you receive as a result of their instructions, except where they have agreed otherwise.
  4.2 You safeguard money and *assets* entrusted to you by *clients* and others.
  4.3 You do not personally hold *client money* save as permitted under regulation 10.2(b)(vii) of the Authorisation of Individuals Regulations, unless you work in an *authorised body*, or in an organisation of a kind *prescribed* under this rule on any terms that may be *prescribed* accordingly.

Referrals, introductions and separate businesses (paras.5.1 and 5.2):

- 5.1 requires of a solicitor, registered European lawyer (REL) or registered foreign lawyer (RFL):

  5.1 In respect of any referral of a *client* by you to another *person*, or of any third party who introduces business to you or with whom you share your *fees*, you ensure that:

  (a) *clients* are informed of any financial or other interest which you or your business or employer has in referring the *client* to another *person* or which an *introducer* has in referring the *client* to you;
  (b) *clients* are informed of any fee sharing arrangement that is relevant to their matter;
  (c) the fee sharing agreement is in writing;
  (d) you do not receive payments relating to a referral or make payments to an *introducer* in respect of *clients* who are the subject of criminal proceedings; and
  (e) any *client* referred by an *introducer* has not been acquired in a way which





would breach the *SRA's regulatory arrangements* if the *person* acquiring the client were regulated by the *SRA*.

- 5.2 states that where it appears to the SRA that a solicitor, REL or RFL has made or received a referral fee, the payment will be treated as a referral fee unless they show that the payment was not made as such.

Client information and publicity (paras.8.6 and 8.7):

- These set out the following:

  8.6 You give *clients* information in a way they can understand. You ensure they are in a position to make informed decisions about the services they need, how their matter will be handled and the options available to them.
  8.7 You ensure that *clients* receive the best possible information about how their matter will be priced and, both at the time of engagement and when appropriate as their matter progresses, about the likely overall cost of the matter and any *costs* incurred.

It is worth noting that para.7.1 in the Code of Conduct for Firms makes it clear that client information and publicity are also the responsibility of the firm.

## 1.9 GEOGRAPHICAL SCOPE OF THE RULES

The SRA Accounts Rules apply to a practice carried on from an office in England and Wales.

Where a firm has a practice outside England and Wales (for example a branch office or subsidiary), this must comply with the SRA Overseas and Cross-border Practice Rules, and within those, rule 3.1 regarding client money. Rule 3.1 is dealt with in **Chapter 11**.

## 1.10 RELS AND RFLS

Following the UK's exit from the European Union and the end of the implementation period on 31 December 2020 the arrangements in relation to former RELs have now come to an end (except in relation to a defined group of Swiss lawyers). Former RELs are automatically passported to RFL status (unless they choose not to be).

An RFL is a foreign lawyer who is registered with the SRA. In order to be eligible to be registered with the SRA the profession of which the foreign lawyer is a member must be approved by the SRA as appropriately regulated; that profession's own rules must allow practice with solicitors in England and Wales; and the SRA's character and suitability requirements must be met. A foreign lawyer must be registered if they wish to be an owner or a manager of an authorised law firm (but not a licensed body) but cannot be a sole practitioner. Once registered with the SRA an RFL can carry out any unreserved work although there are certain limits on reserved activities, and they are subject to the same regulatory standards as a solicitor.

## 1.11 TRUSTEESHIPS IN PERSONAL CAPACITY

Trusteeships undertaken by solicitors in a purely personal capacity (for example a family trust where the administration is not undertaken by the firm) will be outside the requirements of the SRA Accounts Rules. If a solicitor is charging for the work then that work is clearly being undertaken by the solicitor in a professional capacity and the solicitor is therefore subject to the Rules. The use of professional stationery could also indicate the work is being done in a professional capacity.

Previously, rule 5 of the 2011 Rules contained specific details of the persons to whom those rules did not apply. This list included employees of local authorities and statutory undertakers (e.g. persons authorised by an enactment to carry on railway, road or water transport undertakings or public electricity, gas, water or sewerage undertakers, the Environment Agency, the Civil Aviation Authority and certain airport operators, and bodies whose accounts are audited by the Comptroller and Auditor General). Solicitors who are employees of the Duchies of Lancaster or Cornwall or the Church Commissioners were also exempt from compliance with the 2011 Rules, as was the solicitor who practises as the Solicitor of the City of London, and any solicitor carrying out the functions of a coroner, a judicial office, a sheriff or an under-sheriff.

In contrast, rule 1 of the SRA Accounts Rules confirms whom the SRA Accounts Rules apply to – namely authorised firms and those within the firm – and it follows that the Accounts Rules do not apply to those not covered under rule 1. One aspect of the shortened rules is that (unlike the previous version) they do not repeat provisions, requirements or exemptions that are already included in primary legislation. The exempt persons detailed in rule 5 of the 2011 Rules are contained in the Solicitors Act 1974, s.88(1) and the Legal Services Act 2007, s.193. The position therefore remains unchanged.

## 1.12 SOLICITORS IN NON-SRA REGULATED FIRMS

One effect of the Legal Services Act 2007 is that solicitors can choose to practise in firms authorised by a regulator other than the SRA. For example, a solicitor could be employed by or be a partner in a firm of licensed conveyancers. When the solicitor is acting within the scope of their firm's authorisation, and client money is received by the firm as part of a conveyancing transaction, that money in this case would be subject to the regulations of the Council for Licensed Conveyancers and not the SRA Accounts Rules.

Essentially, if a solicitor is regulated not by the SRA, but by another regulator, the solicitor can only hold client money within that particular regulator's rules.

Where a solicitor (as a solicitor) wishes to carry on reserved legal activities, they can only do so through a firm that is regulated by a Legal Services Act 2007 approved regulator or as a freelancer who is subject to reg.10.2(b) of the SRA Authorisation of Individuals Regulations (see **1.13**).





The changes that the SRA introduced in November 2019 allow a solicitor (as a solicitor) to carry on non-reserved legal activities in an unregulated business or as a freelancer, under reg.10.2(a) of the SRA Authorisation of Individuals Regulations. In this case the solicitor does not need to be in a firm authorised by the SRA or any one of the other approved regulators.

## 1.13 FREELANCE SOLICITORS

The term freelance solicitor is used by the SRA to describe a self-employed solicitor who is practising on their own, in their own name, does not employ anyone else, and is engaged directly by clients with fees payable directly to them by those clients.

Previously it was necessary for any solicitor practising alone to have their practice authorised by the SRA as a recognised sole practice. However, following the regulatory reforms in November 2019 it is now possible for some services to be offered without the practice itself being authorised, and for the solicitor to operate as a freelance solicitor.

Where a solicitor only provides non-reserved legal services and does not provide immigration, claims management or regulated financial services (unless under the regulation of another suitable regulator), the solicitor does not need to be SRA authorised, although they can still choose to be.

While, generally speaking, reserved legal services can only be provided through an entity that is authorised to do so, reg.10.2(b) of the SRA Authorisation of Individuals Regulations sets out certain conditions that, if met, would allow a solicitor practising as a freelance solicitor to provide these services without SRA authorisation. The specific SRA Accounts Rules condition to satisfy is rule 2.2 (see **4.8**). As no other 'client money' can be held and no client account can be operated (as the freelancer is not authorised), if any other 'client' monies are required to be held the freelance solicitor will have to, for example, look to using a third party managed account (see **Chapter 9**).

Solicitors wishing to operate in this way need to notify the SRA.

## 1.14 IN-HOUSE SOLICITORS

Solicitors outside an authorised firm cannot personally hold client money. So in the case of an in-house solicitor, any money would be the business' money and the SRA Accounts Rules do not apply.

## 1.15 THE SOLICITORS DISCIPLINARY TRIBUNAL

The SRA itself has limited powers to impose sanctions on solicitors; for example, the SRA's powers to fine individual solicitors are limited to £2,000 and the SRA is

not able to strike off a solicitor. The SRA does have more robust powers in relation to certain types of legal business and it can impose a fine of up to £250m on a licensed body and up to £50m on managers or employees of these bodies.

Sanctions for solicitors from the SRA can range from providing a letter of advice (reminding an individual or a firm of their regulatory responsibilities), through to rebukes, implementing practising conditions (placing some restrictions on an individual or a firm), up to fines and ultimately either suspension or revocation of a firm's authorisation.

In addition it is worth noting that the SRA (and the Solicitors Disciplinary Tribunal (SDT)) is also able to impose a s.43 order (Solicitors Act 1974) on a non-lawyer, including support staff, which restricts an individual from working in a law firm without the SRA's permission.

Where the SRA can reach an 'Agreed Outcome' with the solicitor, this must be approved by the SDT. If agreement cannot be reached or where the SRA takes the view that more serious sanctions are required, whether these are higher fines, additional restrictions or indeed striking off, the case must be taken to the SDT.

The SDT is wholly independent of the SRA and the Law Society. It is constituted as a statutory tribunal under the Solicitors Act 1974, s.46.

The SDT adjudicates upon alleged breaches of the rules and regulations applicable to solicitors and their firms, as well as upon the alleged misconduct of RFLs and employees of solicitors. Where a solicitor has previously been struck off the Roll the SDT also decides applications by such solicitors for restoration and those from indefinitely suspended solicitors for determination of suspension. All decisions are subject to a right of appeal to the High Court.

The SDT members (around 40) are all appointed by the Master of the Rolls, with a mix of solicitor and lay members, drawn from a wide range of backgrounds to reflect the make-up of the profession and, as far as possible, the public.

Decisions made by the SDT are publicly available at **www.solicitorstribunal.org.uk** and inevitably in a significant number of cases breaches of the SRA Accounts Rules feature. Anyone dealing with the SRA Accounts Rules would be well advised to take a regular look at recent decisions to pick up any common themes and problems, ensuring that their own firm's systems and procedures guard against similar breaches as far as practicable.



CHAPTER 2

# SRA Accounts Rules: an overview

## 2.1 INTRODUCTION

Traditionally solicitors have held large sums of money on behalf of clients and so there has been a need for some regulation relating to the handling of that money. A set of Accounts Rules has been in existence in various guises since the first requirement in the 1945 version to separate the firm's money from money belonging to clients. The changes and updates during most of that time led to more and more detailed and prescriptive rules being brought into force, up until the latest version, implemented on 25 November 2019.

In a shift away from decades of prescription the SRA has implemented rules that are much shorter, far less detailed and prescriptive, and are based on clear principles of protection. If you are looking at these rules for the first time you might be forgiven for thinking that it all looks pretty straightforward with relatively low compliance obligations – primarily because they are so short. That would be a mistake. The protection of 'other peoples' money' is a key priority for the regulators.

The consequences of failure in this regard can be significant for the client, the firm, its owners and indeed the reputation of the legal profession.

## 2.2 KEY PRINCIPLES

While it has always been very important to understand the overall objectives of the Rules and the principles underpinning them, this could perhaps now be seen as more important than ever. The lack of prescription under the SRA Accounts Rules does allow more scope for differences between firms. These differences, as will be seen in later chapters, could manifest themselves in a couple of ways:

- interpretation – for example, in determining what constitutes 'promptly' when banking client money;
- the holding of funds – for example, continuing to hold large sums in a client account versus holding no client money by making use of a third party managed account.

The overarching objective is to keep clients' money safe and the key principles behind achieving this are:

- keeping clients' money separate from the firm's money;
- only using the money for its intended purpose; and
- returning funds as soon as there is no need to retain them.

While the Rules do include a number of very specific requirements, including those above, the introduction to the SRA Accounts Rules states:

> Firms will need to have systems and controls in place to ensure compliance with the rules and the nature of those systems must be appropriate to the nature and volume of client transactions dealt with and the amount of client money held or received.

What constitute appropriate systems, controls and procedures will differ from firm to firm. In a practice with a large number of partners and fee earners segregation of duties will play a vital role in ensuring the firm has robust controls in place. However, for sole practitioner solicitors, maintaining all of their own accounting records, this will be neither possible nor necessary.

The SRA has produced guidance on this area to help firms consider what is appropriate: 'Helping you keep accurate client accounting records'. Examples from this guidance will be used throughout this handbook.

## 2.3 WHAT IS REQUIRED?

The firm must ensure that client money and any third party money are properly protected, and that the firm complies with both the SRA Accounts Rules and the underlying principles. Alongside those rules and principles, the firm must ensure that its own systems and procedures are capable of providing that protection. There is no 'one size fits all' approach to this.

Set out below are the most fundamental questions in respect of all the money involved in a client's matter – whether the money belongs to the client, another third party or the firm – that need to be addressed by the 'accounting system' and those responsible for it.

## 2.4 KEY QUESTIONS

1. What money is being received and held?
2. Where must it be held?
3. When and how can or must it be used?
4. What record keeping and other obligations arise while the money is held, and the work is being done?
5. How should any 'final' balance be dealt with?





6. Should I/we be holding and paying out these funds?
7. Is there an alternative approach?

The 'accounting system' is made up of the people (partners/members/directors, fee earners, the accounts team and in all likelihood other support staff) as well as the actual record keeping and software being used.

The following chapters will deal with each of these questions in turn and then look at some of the other issues that will often arise.

## 2.5 WHAT IS NOT COVERED UNDER THE RULES?

A key point to highlight is that the SRA Accounts Rules are only directly concerned with monies that relate to client matters. All legal practices will receive and hold money and make payments that relate to the running of the practice and not to client matters.

Examples could include:

- receipts of capital from partners;
- rental income on partnership property;
- payment of staff salaries;
- payments to HMRC for PAYE and national insurance;
- professional indemnity insurance premium costs;
- staff training expenses.

These are not dealt with under the SRA Accounts Rules directly, but the fundamental principle is that these monies belong to the business and have nothing to do with the client account – they must never be held in/paid out of the client account.

CHAPTER 3

# What money is being received and held?

The following chapters (**Chapters 3** to **8**) will cover the fundamentals of the rules regarding the handling of the relevant monies throughout the client matter. In essence: we have a client, and we are going to receive and hold money while we carry out legal work for them. What do we need to do with that money initially and as the matter progresses?

The later chapters will look at some of the alternative requirements or choices.

## 3.1 WHO IS A CLIENT?

First things first. Unless the law firm has a client, the firm should not be receiving money into bank accounts of any kind under the SRA Accounts Rules.

The term client is defined in the SRA Standards and Regulations Glossary as meaning 'the person for whom you act and, where the context permits, includes prospective and former clients'. Additionally, the Glossary clarifies that:

> [I]n the SRA Financial Services (Scope) Rules, in relation to any regulated *financial services activities* carried on by an *authorised body* for a trust or the estate of a deceased person (including a controlled trust), [client] means the trustees or personal representatives in their capacity as such and not any person who is a *beneficiary* under the trust or interested in the estate.

## 3.2 WHAT IS THE MONEY THAT IS BEING RECEIVED?

Once a firm has undertaken all the other required regulatory procedures, such as checks to comply with the relevant money laundering regulations, the first question is: what funds are we going to receive?

How will the receipt of funds be defined under the Rules? This is not a judgement to be made by the firm as the nature of the funds is defined specifically in the SRA Accounts Rules.

Under the SRA Accounts Rules there are basically two 'types' of money: money that is specifically defined as 'client' money, and anything else. In this context, the non-client money is 'business' money (you may also hear it referred to in practice as





'office' money, although this term is no longer used in the Rules themselves). This will be referred to as the firm's money or business money throughout this handbook.

The relevant definitions are covered in Part 2 of the Rules.

Rule 2.1 '*Client money*' is money held or received by you:

(a) relating to *regulated services* delivered by you to a *client*;
(b) on behalf of a third party in relation to *regulated services* delivered by you (such as money held as agent, stakeholder or held to the sender's order);
(c) as a trustee or as the holder of a specified office or appointment, such as donee of a power of attorney, Court of Protection deputy or trustee of an occupational pension scheme;
(d) in respect of your *fees* and any unpaid *disbursements* if held or received prior to delivery of a bill for the same.

Any money held or received by the firm when acting on behalf of a client will fall within these rules. However, the definitions above make it clear that money held or received in certain other capacities will also be client money.

### 3.2.1 Agent/stakeholder

Where a firm acts on the sale of an asset (typically acting for the seller on the sale of a property on a conveyancing transaction) a deposit may be required from the purchaser and paid to the seller's solicitors. The contract will normally state whether the deposit is to be held by the seller's solicitors as agent for the seller or as stakeholder. If the deposit is held as agent for the seller, the solicitor may pay this money over to the client before completion. In a conveyancing matter this might be appropriate if the client is also buying a property and wants to use the deposit money for payment of the deposit on the property being bought.

However if the seller's solicitor is holding the money as stakeholder, the stakeholder (in this case the firm) is the principal for both parties and the firm can hand the deposit to either party without the consent of the other, providing the firm is confident that the conditions for payment have been met. This would normally be on completion of the transaction, which would allow the firm to make the payment to its seller client.

Regardless of whether the money is received by the firm as agent or stakeholder it is client money under the Rules. Where the firm is acting as agent the client's identity is clear, but where the firm is acting as stakeholder the money is not payable to the client until the occurrence of the specified event. How this should be recorded is covered in **Chapter 6**.