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CHAPTER 1 - INTRODUCTION

1. Introduction

What is the COFA and who should be the COFA?

WHEN THE new regime was introduced with effect from 1st January 2013 and the new roles of COLP (Compliance Officer for Legal Practice) and COFA (Compliance Officer for Finance & Administration) were announced, there was an immediate panic across the legal profession about these changes and whether this was a good thing to be doing in the middle of a severe recession.

The aim of this new approach to regulation is to identify key people who will be the primary contact of the SRA for reporting and for discussing any problems which might arise. This is a sound idea and it is hoped that the COLP and COFA will provide focus within a firm to serve clients in the best possible way. This should lead to more stable and successful legal businesses, which should mean the SRA can have more confidence in the long term viability of legal services and that the good name of the legal profession can be maintained. In the first few months of 2013 the SRA received about double the number of reports compared to previous levels. This suggests that the changes had an immediate effect on the reporting of issues to the SRA.

So where does the requirement for a COFA come from? The answer is Rule 8.4(d) of the SRA Authorisation Rules for Legal Services Bodies and Licensable Bodies 2011 (Authorisation Rules), which states that:

“An authorised body must at all times have an individual who is a manager or an employee of the authorised body; who is designated as its COFA; who is of sufficient seniority and in a position of sufficient responsibility to fulfil the role; and whose designation is approved by the SRA.”

This means that the COFA role cannot be outsourced or performed by a third party, such as the reporting accountant. The COFA does not need to be a manager and can simply be an employee. The SRA needs to approve the COFA and to help them to decide upon the suitability of the applicant they have a Suitability Test. When deciding upon who should be the COFA it is also important to consider the role of the COFA to ensure the applicant has the required knowledge, skills and authority. Rule 8.4(e) of the Authorisation rules outlines the role of the COFA as follows:

“The COFA of an authorised body must take all reasonable steps to ensure that the body and its employees and managers comply with any obligations imposed upon them under the SRA Accounts Rules; record any failure so to comply and make such records available to the SRA on request; and in the case of a licensed body, as soon as reasonably practicable, report to the SRA any failure so to comply, provided that:

- in the case of non-material failures, these shall be taken to have been reported as soon as reasonably practicable if they are reported to the SRA together with such other information as the SRA may require in accordance with Rule 8.7(a); and
- a failure may be material either taken on its own or as part of a pattern of failures so to comply.

In the case of a recognised body, as soon as reasonably practicable, report to the SRA any material failure to so comply (a failure may be material either taken on its own or as part of a pattern of failures so to comply).”

Guidance note (ix) of the Authorisation rule provides further guidance on who the COFA should be and states:
“Those designated as COFA will need to be in a position to be able to discharge the role. They will need to consider whether they are in a position to, for example:

a. Ensure they have access to all accounting records;
b. Carry out regular checks on the accounting systems;
c. Carry out file and ledger reviews;
d. Ensure the reporting accountant has prompt access to all the information needed to complete the accountant’s report;
e. Take steps to ensure breaches of the SRA Accounts Rules are remedied promptly;
f. Monitor, review and manage risks to compliance with the SRA Accounts Rules;
g. As soon as reasonably practicable report to the SRA any failure to comply with the SRA Accounts Rules. Where such failure is material, either on its own or because it forms part of a pattern, the immediacy of the report will depend on the circumstances and seriousness of the breach. The report need not be made until the annual information report under Rule 8.7 where such failure is neither material of itself nor because it forms part of a pattern of non-compliance."

The SRA is regulating around 11,000 legal businesses. The vast majority of these businesses are small traditional law firms. In such firms, the senior/managing partner is normally also performing the role of both COLP and COFA. This is not really surprising given they are in charge and they are therefore responsible to the SRA for ensuring the firm operates in the correct way.

In larger legal businesses, the role of both COFA and COLP are often separated from the senior/managing partner role. While this is allowed, and might be an appropriate structure, this can lead to conflict when there is a problem within the business which needs reporting to the SRA. While the managing partner might think the issue does not need reporting, the COFA may disagree and is under an obligation to report. This is why some commentators have said that the appointment as a COFA is a career limiting appointment. The important thing to consider when nominating the COFA is that the person must be able to perform the role and have the necessary experience and skills to be able to perform the role.

If the COFA is not the managing or senior partner then who might be the right person? Given that the role is heavily about compliance with the Accounts Rules, it might be that the Financial Director or Accounts Manager or Practice Manager might be an appropriate appointee. There are also legal businesses where the COFA is the CEO or COO or the Finance Partner, which demonstrates that the SRA accepts that different legal businesses will run themselves in different ways and that there are, therefore, various people who may be able to perform the role satisfactorily.

The relationship between the COFA and the COLP

While in many legal businesses the COLP and the COFA are the same person, there are many legal businesses where this is not the case and the roles are being performed by different people. When the COLP and COFA roles are to be performed by different people, it is important to make sure there are clear job descriptions for both roles - otherwise there is a danger of duplication or of some responsibilities falling between two stools.

The Authorisation Rules state that “the COLP must take all reasonable steps to ensure compliance with the terms and conditions of the authorised body’s authorisation except any obligations imposed under the SRA Accounts Rules”.

In other words, the COLP is responsible for everything other than compliance with the Accounts rules. Having said that, there are certain responsibilities of the COLP which might be better controlled by the COFA, who might have better and more appropriate skills, knowledge or experience.

To understand where there might be a need for further clarification over the responsibilities of the COFA and the COLP it is necessary to look at...
the SRA Code of Conduct 2011 (The Code). The Code contains 10 principles that must always be considered when determining how legal businesses should behave. The 10 principles are as follows:

1. Uphold the rule of law and the proper administration of justice;
2. Act with integrity;
3. Not allow your independence to be compromised;
4. Act in the best interests of each client;
5. Provide a proper standard of service to your clients;
6. Behave in a way that maintains the trust the public places in you and in the provision of legal services;
7. Comply with your legal and regulatory obligations and deal with your regulators and ombudsmen in an open, timely and co-operative manner;
8. Run your business or carry out your role in the business effectively and in accordance with proper governance and sound financial and risk management principles;
9. Run your business or carry out your role in the business in a way that encourages equality of opportunity and respect for diversity; and
10. Protect client money and assets.

So which of these principles might be better tackled by the COFA or at least benefit from some contribution from the COFA? It is particularly principles 8 & 10 where this might be true but there might be other principles where the COFA might be able to help too.

The Code is then divided into five sections as follows:

1st section: You and your client
- Chapter 1 - Client care
- Chapter 2 - Equality and diversity
- Chapter 3 - Conflicts of interests
- Chapter 4 - Confidentiality and disclosure
- Chapter 5 - Your client and the court
- Chapter 6 - Your client and introductions to third parties

2nd section: You and your business
- Chapter 7 - Management of your business
- Chapter 8 - Publicity
- Chapter 9 - Fee sharing and referrals

3rd section: You and your regulator
- Chapter 10 - You and your regulator

4th section: You and others
- Chapter 11 - Relations with third parties
- Chapter 12 - Separate businesses

5th section: Application, waivers and interpretation
- Chapter 13 - Application and waivers provisions
- Chapter 14 - Interpretation
- Chapter 15 - Transitional provisions

The chapters that will be most relevant to the COFA will be chapter 7 – “Management of your business” and chapter 10 – “You and your regulator”, but there might be other chapters that could overlap with what the COLP is managing, such as chapter 1 – “Client care”.

The Code is written using outcomes focused regulation. Each chapter of the code describes some outcomes that need to be achieved if a legal business is to be compliant with the stated principles in the Code. The outcomes should not be seen as everything that is required as it may be necessary to achieve additional outcomes if all of the Principles are to be met.

The outcomes in chapter 7 of the Code which deal with the “Management of your business” are as follows:

7.1 You have a clear and effective governance structure and reporting lines;
7.2 You have effective systems and controls in place to achieve and comply with all the Principles, rules and outcomes and other requirements of the Handbook, where applicable;
7.3 You identify, monitor and manage risks to compliance with all the Principles, rules
Creating the business plan

All businesses should have a business plan which states what the business hopes to achieve over the next 3-5 years and how these objectives are to be achieved. Without a medium-term business plan, there is a danger that the business just focuses on short-term performance and does not invest in areas that need to be addressed if the business is to grow sustainably over longer periods of time in a changing marketplace. Legal businesses are no different and they need a plan. The plan can be for the whole business or there can be separate plans for different parts of the business.

So how do legal businesses create credible business plans? The plan has to be capable of being implemented and it must therefore focus on the expectations of everyone that needs to be satisfied if the legal business is to achieve its ambitions. The following parties will need to be considered:

a. **Owners** – the owners of a legal business will probably also work in that business. They will expect to be properly paid for the job they are doing and to earn a return for the risk they are taking and on the capital they have invested. If the business plan does not meet or exceed their expectations then the owners might walk away from the business, sell it or close it down.

b. **Clients** – the expectations of clients of legal businesses have changed considerably in recent years. They are usually looking for a better service that is delivered faster and at a lower price than was the case in the past. If legal businesses cannot satisfy the expectations of clients then the business is unlikely to be able to satisfy the expectations of the owners.

c. **Employees** – the employees of legal businesses need to be committed to delivering exceptional client service. Legal businesses therefore need to understand what their employees expect from their job and ensure that the business is investing in the right areas to maintain employee motivation and loyalty.

d. **Suppliers** – legal businesses will rely heavily on suppliers other than their staff. It is important to consider the needs of these suppliers too if the business is to expect continuing support and loyalty from suppliers. This might not involve spending money but it might require an investment of time so that suppliers are kept informed of developments and feel fortunate to be a supplier of the legal business.

e. **Local community** – it is true for any business that if you are going to be successful then you will need to be seen to be putting something back into the local community. If this is not being done then the community might be less inclined to instruct the legal business on legal matters than if they were central to that community.

How is a business plan constructed? Many legal businesses make the mistake of starting by deciding where they want to be in 5 years’ time. Then, having decided upon the ultimate goal, a plan is worked up which describes what needs to be done to achieve this goal. Where is the mistake in this process? It is impossible to decide upon a strategy until you are clear about where you are, where the competitors are and to have considered likely market changes over the period of the plan. Only then would it be sensible to think about the direction of travel. *Figure 2.1* (p6) shows a sensible process to follow to develop a credible business plan.
How do we start to have a better understanding of where the business is and how it is performing? This could begin with several people being asked to complete a SWOT analysis, which would look like this:

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<tr>
<td>Opportunities</td>
<td>Threats</td>
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Once the SWOT has been completed, it is important to challenge what has been included by asking the following questions:

1. Would other people have said the same? If not, should we consider the views of others too before reaching any conclusions?
2. Would the same things have been included in the SWOT if the exercise was completed six weeks ago or in six weeks time? People tend to focus on the here and now when completing a SWOT rather than focusing on the longer term strategic issues.
3. Do you think you should cross out anything for which you do not have evidence? Given the plan is the basis for how the business is to operate for the next 3-5 years it is important it is based on fact and not just the perceptions of a few people.

It becomes clear there is normally a need for some detailed research to better understand the current position of the firm. How is this research undertaken? There are a number of sources of information:

1. **Financial analysis** – By looking at the accounts for the last few years, it should be possible to better understand the financial position of the firm, especially if the performance is properly benchmarked against that of competitors.
2. **Client feedback** – Ultimately, it is the views of clients that are more important for the success of the business than any thoughts from people working within the business. You need to get better at asking for and collecting feedback from clients. Feedback, if it is sought, is often collected after the matter has completed. Isn’t this too late? Perhaps we should look to get feedback every time there is an interaction with a client. This could be done by asking a client a question like “Give me one thing that we could do to improve our service?”. If everyone did this every time they interacted with a client it would be possible to very quickly tailor the service to each and every client. It would also provide the business with a much clearer understanding of client needs when preparing the business plan.
3. **Staff feedback** – Staff can be asked to provide feedback in a number of ways. The appraisal process is one way, but we can also ask staff to complete a SWOT and we can also review the comments made at exit interviews when people leave the business.

Once we understand our own business, the next step is to identify and consider our likely competitors for the next 3-5 years. Identifying likely competitors might be easy or difficult depending upon the type of work we do and where we are based. Having identified the competitors, we then need to undertake a SWOT analysis on each of them. Once again, we will also need to ensure that we can verify these SWOTs with evidence. How can we obtain facts about our competitors? We can review their accounts for the last few years. We can ask our clients about why and when they would use other legal businesses to try and under-
stand the difference between our business and that of our competitors in the eyes of our clients. We could even start entry interviews for new staff who are joining from competitors; the idea being to see what information they are able to share with us.

Finally, we need to consider likely changes to the marketplace over the period of the plan. The changes will vary, depending upon the nature and position of the legal business, but some of the more common issues that need to be considered include:

1. Consolidation and mergers within the legal market;
2. Evolving client expectations;
3. Regulatory changes;
4. The likely performance of the economy;
5. Changes to the law;
6. Fee pressures and the need for more creative fee arrangements; and
7. The drive to greater efficiency through outsourcing, offshoring and investment in information technology.

Having done the research, you can now put the business plan together. There is no correct way of constructing the plan but there are five common headings that are seen in the business plans of legal businesses which are worth considering here:

1. **Profitability** – this section of the plan will describe the revenue streams over the period of the plan. For example, does the business plan to continue to generate revenue from both private clients and businesses or is it now just going to focus on one stream? If business income has arisen from employment, real estate and corporate work, is this the work the firm wants to do in future or does it plan to drop a source of income or add another one?

Once the income streams are defined the plan then needs to talk about how the volumes of each revenue stream will increase or decrease over the period of the plan and how this is to be achieved. For example, the plan might be to increase revenue for a type of work by reducing the price, or alternatively, by trying to improve the value to the client with the same or an even higher price. The final thing to consider under this heading will be the proposed margin for each revenue stream and how this margin is to be achieved.

2. **Financing** – how are you going to ensure the firm does not run out of money during the period of the plan? This will involve consideration of any new finance required for investment and where the money will come from, as well as ensuring cash flows from the day-to-day business are sound and there is proper control over billing and cash collection processes.

Given the finance will need to come from a bank or the owners it is important to reflect on how much capital an owner will be expected to put into the business, how quickly they will be allowed to withdraw any profits made by that business and how quickly they will be able to withdraw their capital when they exit the business.

3. **Growth** – for a legal business to increase profits it does not need to get any bigger, it could simply become more efficient in the way it operates. Having said that, large increases in profit can normally only be achieved with significant increases in revenue. So how can this be achieved?

*Figure 2.2 shows the normal position for revenue in legal businesses. The top third of*
Introduction and Overview

The Solicitors Regulation Authority Accounts Rules (SARs) represent a particular challenge for those who are required to comply with these detailed and sometimes complex rules. The role of Compliance Officer for Finance and Administration (COFA) encompasses a number of detailed responsibilities in connection with the legal business’s compliance with these rules as well as a requirement to report, directly to the Solicitors Regulation Authority (SRA), in certain circumstances instances of non-compliance with the rules.

It perhaps goes without saying there is no substitute for a detailed knowledge of the SARs and this can only be achieved by examining the rules in full. This handbook does not reproduce the SARs in full and should not be relied upon to provide a complete guide to the subject, rather a useful reference for many of the key issues and current guidance.

Changes in October 2011 and January 2013

With the approval of Alternative Business Structures (ABSs) the SARs were amended to ensure the Solicitors Regulation Authority (as an approved regulator) was able to deal with these new structures within the rules and so some of the language of the rules was changed. For the ‘traditional law firm’ this will make no real difference in practice, but it does highlight the fact that these rules are no longer called the Solicitors Accounts Rules as they are not just for solicitors. For clarity, however, where these notes refer to either ‘solicitor’ or ‘you’ this should be regarded as meaning the firm or those regulated under the rules in the broadest sense. The SARs only apply to those activities for which the business is regulated.

ABSs are referred to as ‘licensed bodies’ under the SARs and there is a section in this chapter that highlights some of the more specific references to such bodies within those rules.

The latest changes to the rules were effective from 6 October 2011. The changes to the rules did not have retrospective effect.

One of the key features of Outcomes Focussed Regulation is, of course, the appointment of the COFA and the specific responsibilities that the COFA has in relation to SAR compliance. This became effective on 1 January 2013.

The first issue for any COFA has to be consideration of the SARs themselves.

The questions listed below are all key issues for the COFA to address:

- Is my knowledge of the accounts sufficient so I am confident I can deal with issues that arise regarding breaches?
- How well do the accounts team know the rules?
- Are there any knowledge gaps that need to be filled with training?
- Have previous breaches arisen that remain an issue?
- How up to date and robust are our accounting systems and procedures?

The following sections in this chapter deal first with the detail of many of the key SARs, then cover guidance for the COFA dealing with ensuring compliance with the SARs and finally highlighting some of the more common breaches.

SRA Handbook Principles

Before looking at the more detailed and very specific requirements of the SARs, it is worth taking a look at the ‘big picture’. The principles outline the basic purpose of the SARs and underpin all the detailed requirements of the rules. These apply whatever structure the business takes. As part of Outcomes Focussed Regulation the SRA’s Handbook contains 10 mandatory principles. The introduction to the SARs includes five of those principles that the SRA deem to be espe-
cially relevant to SARs compliance. These require you to:

- Protect client money and assets;
- Act with integrity;
- Behave in a way that maintains public trust;
- Comply with the rules and co-operate with the SRA; and
- Run the business, or carry out your role in the business effectively with sound financial and risk management principles.

The desired outcomes which apply to the rules are:

- Client money is safe;
- Clients and the public have confidence that client money is safe;
- Firms are managed in such a way, and with appropriate systems and procedures in place, to safeguard client money;
- Client money is only used appropriately; and
- The SRA is aware of issues in firm relevant to the protection of client money.

The scope of the rules and responsibilities

**Rule 3 – Geographical scope**

The detailed rules apply to your practice which is carried on from an office in England and Wales. Where you have any overseas offices these are dealt with under a separate part of the SARs (currently rules 47 to 52). These are reviewed on p39 - ‘Overseas practice’.

**Rules 4 and 6 – Persons governed and responsibility for compliance**

As referred to earlier the changes that were made in October 2011 were largely due to the widened application of the rules.

Those governed by the SARs are:

- Sole practitioner solicitors or Registered European Lawyers (RELs);
- Solicitor, REL and Registered Foreign Lawyer (RFLs) Partners;
- Solicitors or RELs employed as an assistant, associate, professional support lawyer, consultant or locum;
- Any other ‘managers’ or employees;
- Solicitor, REL and RFL Directors;
- Solicitor, REL and RFL Members of LLP firms;
- Solicitors and RELs employed as in-house lawyers;
- A recognised body;
- A licensed body.

In all cases the appointments are by reference to recognised sole practitioners, recognised bodies, authorised non-SRA firms as well as sole practitioners and partnerships that should be recognised but have not been authorised by the SRA.

The term manager when used in the SARs means members of LLPs, directors of companies and partners in partnerships. If the structure is a different type of body a member of its governing body would be deemed to be a manager.

As far as the principals are concerned they are not only responsible for their own compliance but also for ensuring the compliance of everyone else in the organisation. If any employee is in breach of the rules the principals will also be held to be in breach. This responsibility also extends to the COFA even if they are not a principal.

**Rule 7 – Duty to remedy breaches**

Virtually all legal practices will have some breaches of the rules. The rules require that any breaches noted should be remedied promptly on discovery.

**Key principles**

**Rule 1 – The overarching objectives and underlying principles**

The SRA principles from the handbook detailed earlier are fairly broad and apply to other areas of practices whereas this rule provides those principles that are entirely accounts rules related, but again serve to provide the starting point from which all the detailed rules are generated.

The main points to highlight from these principles are:
CHAPTER 3 - SOLICITORS REGULATION AUTHORITY ACCOUNTS RULES 2011

1. Separation – money deemed under the rules to be office money must be kept separate from money held or received for other people;
2. Client account – money held for other people must (unless the rules specifically say otherwise) be placed in a client account;
3. Use of client money – this must only be used for that client's matter(s);
4. Accounting systems – proper accounting systems and internal controls must be established to ensure compliance with the rules;
5. Interest – this should be accounted for in accordance with the rules;
6. Accountant’s Reports – these must be delivered as required by the rules.

Main definitions

Rule 2 – Interpretations
As with any set of rules, definitions are crucial. There are a number of definitions under the SARs that do not necessarily tie in with the way some of these terms may be used on a more general or ‘commercial’ basis. The definitions under the SARs are, of course, the only ones that matter when it comes to compliance. The full schedule of relevant definitions is now contained in The SRA Handbook Glossary 2012. The following have been detailed as they do on occasion cause misunderstandings.

- Fees are your “own charges or profit costs (including any VAT element)”. This would also include any so-called ‘general’ or ‘soft’ costs that may also be charged, such as for in-house photocopying, travel expenses and so on. These should not be confused with the disbursements defined under the rules below;
- A disbursement is “any sum spent or to be spent on behalf of the client or trust (including any VAT element)”. This is an amount specific to that client/trust and purely arises as a direct result of dealing with their transaction. In accordance with this definition all that can be charged to the client/trust is the amount you spend;
- Professional disbursements are the fees of professionals, agents or experts “instructed by you”. Most typically these will be the fees of counsel and other experts including, for example, medical experts, accountants, and translators;
- Costs are not the same as fees. Any reference to Costs under these rules means “your fees (as defined above) and disbursements (as defined above);
- Without delay means the same or the following working day.

It is worth noting that the term ‘profit costs’ is only used in respect of the solicitors own charges – i.e. as already mentioned, profits cannot legitimately be made on disbursements.

Rule 12 - Categories of money
There are only two types of money covered under the SARs, client money and office money. With the changes in October 2011 the rules also refer to “out of scope” money which is “money held or received by an MDP (multi-disciplinary practice) in relation to those activities for which it is not regulated by the SRA”. Out of scope money is not considered further here.

Client money
This is, at its most obvious, money that belongs to the client/trust, and it should be very apparent that it would be defined as client money under the rules; for instance, money for damages awarded, the proceeds to selling the clients business or property. However, it also includes all other money received and held which is not deemed to be office money. The effect therefore is that if the money can’t be shown to be office money then, by default, it will be client money. There does however need to be a client/trust matter that this money relates to.

If during the course of the client matter money is received for any of the following purposes it will be deemed client money and must be treated as such:

- Money received on account of costs generally;
AML - Risk & Compliance Toolkit

Introduction
The purpose of this chapter is to focus on the issue of money laundering and the associated anti money laundering procedures (“AML”) as fundamental to legal and business risk management. This chapter is not a substitute for the legislation and regulations which pepper this area. It has a rather more limited aim in providing a short AML “toolkit” of resources that may provide a useful supplement to the legislation.

One of the most taxing issues in relation to AML compliance and the assessment of AML risk in the legal sector is that the spectre of criminality raises its head in the context of the legal retainer. The fact the legal professional is effectively performing the role of fiscal gatekeeper seems at odds with the duty of confidentiality and client fidelity, which is at the heart of that retainer. Secondly, many practitioners feel ill equipped to be on guard for the multiplicity of “red flags” to which they should have regard in transactions as varied as selling a house, administering a trust or applying for a Grant or Representation. Consideration of the recent case law may only serve to make the practitioner even more anxious that they may have “missed something” which may be of critical, albeit circumstantial evidence, with the benefit of hindsight. This chapter highlights a variety of useful resources and tools to assist in the identification of situations where criminals seek to misuse legal services to conceal or promote criminal activity or subvert enforcement objectives.

The Act and Framework of the Legislation

The classical taxonomy of money laundering
The most basic definition of money laundering is simply disguising the origins of the benefit from criminal conduct. The aim is to place “dirty money” into the financial system and via a series of transactions by which the money is “layered” into the system until it is fully “integrated” and becomes “clean”. The definition is a good one, so far as it goes, but may be a little too mechanistic.

Firstly, not all “proceeds” start as cash. MITIC or carousel frauds do not start as cash transactions and the typology of money laundering is no less inventive. A trader who is able to buy a lease on new and bigger premises from selling counterfeit handbags is a money launderer, as much as the “Mr Big” of a drugs cartel. Selling a counterfeit handbag is a breach of s92 Trade Mark Act 1994, which carries with it criminal sanctions. An offence under the Proceeds of Crime Act (“POCA”) is an added surprise for such a trader, especially as the potential sanctions under POCA are so much more severe than under the Trade Mark Act.

Secondly, there is no requirement within the legislation to actively seek to conceal or obscure the beneficial ownership of the criminal property. The fact that it constitutes the benefit from criminal conduct is sufficient.

Thirdly, money laundering is apt to change its typology. One very recent example is the drive in the United States to apply AML strategies to the new virtual currencies used online, such as Bitcoin. Used initially to buy pizzas and apps and games, its use by criminals as a method of exchange has been a concern over recent months.

Status of the Offences under POCA
Offences under POCA are invariably serious in that the primary money laundering offences can attract a prison sentence of up to 14 years. A simple theft conviction could attract a maximum sentence of up to 7 years. The rationale behind the severe enforcement strategy which underpins AML as a concept is that its severity serves as a deterrence to both the “professional launderer” and the...
The importance of making it more difficult for criminals to legitimise their ill-gotten gains;
- The importance of deterring professional launderers;
- The importance of protecting the integrity of financial institutions domestically and internationally.

The main issue for legal professionals is they may fall into one of the primary money laundering offences under s327-329 of POCA as well as a failure to report in the regulated sector offence under s330. Before turning to the specific details of those sections, it is helpful to consider some of the pivotal definitions at the heart of the POCA and AML framework.

First Principles: Problems of definition

Criminal property and criminal conduct
The definition of criminal property and criminal conduct is at the heart of POCA. The definitions within s340 must be read together to make practical sense of the provisions of the act as a whole. The section repays careful review:

S340 (2) POCA defines criminal conduct as

“conduct which

(a) constitutes an offence in any part of the United Kingdom, or
(b) would constitute an offence in any part of the United Kingdom if it occurred there”

S340(3) defines property as criminal property, if

(a) it constitutes a person’s benefit from criminal conduct or it represents such

a benefit (in whole or part and whether directly or indirectly), and
(b) the alleged offender knows or suspects that it constitutes or represents such a benefit.

Whilst the definition in s340 is spectacularly wide, it also has a curious “mens rea” element embedded within the definition of criminal property. S340(3) is curious in that property effectively “becomes” criminal property for the purpose of making the case against an individual if they know or suspect the property constitutes or represents a benefit from criminal conduct. In order to commit the offence it is necessary to know or suspect and this knowledge or suspicion makes the property criminal property. This safeguard buried within the definition of the critical term “criminal property” is often missed but it is a safeguard against those who are either truly naïve or the victim of a highly organised “scam” which manages to foil the most diligent of procedures falling foul of POCA.

Whilst the practitioner is not required by POCA to go on an unpaid detecting spree in relation to finding criminal conduct and its proceeds, The CPS Legal Guidance for Crown Prosecutors: Money Laundering Offences provides a useful background as to the way evidence of such activity is obtained and this may assist the practitioner when considering the issue of suspicion. It is logical that circumstantial evidence will be critical in proving the benefit of criminal conduct, but there may also be evidence from forensic auditors and, from the point of view of the legal practitioner, “evidence of the unlikelihood of the property being of legitimate origin” can also be vital. Cash rich businesses with unbelievable profit margins or stories of the acquisition of property would also tend to point to a suspicion that criminal conduct may have been involved.

S340 (5) states that a “person benefits from conduct if he obtains property as a result of or in connection with the conduct”. The concept of “benefit” is equally wide. It does not equate to “profit” and merely means “obtains”. There is significant case law in this area which simply
serves to underline the central purpose of the legislation, which is to define the criminal conduct as being an all encompassing “all crimes” definition.

Knowledge
The actual or implied state of knowledge of the offender is a critical element of the POCA framework. The question of whether a particular individual knew, was suspicious, or had reasonable grounds for knowing or suspecting, is a live issue. In its guidance note, the Joint Money Laundering Steering Group (JMLSG) states that “having knowledge means actually knowing something to be true... That said, knowledge can be inferred from the surrounding circumstances; so for example, a failure to ask obvious questions may be relied upon by a jury to imply knowledge.”
Some commentators suggest that even though wilful blindness cannot equate to knowledge it does provide evidence “from which knowledge can be inferred.”

Suspicion
Suspicion is another problematic concept. Firstly, the term is not used consistently throughout the legislation and appears in various guises: suspect/ reasonable grounds to suspect/reasonable cause to suspect. Secondly, the courts have struggled to provide a succinct definition of the concept. Although the suspicion bar is set fairly low in connection with POCA, just how low? The most compelling definition may well be found in the case R v Da Silva:

“the essential element in the word “suspects” and its affiliates, in this context, is that the defendant must think that there is a possibility, which is more than fanciful, that the relevant facts exist. A vague feeling of unease would not suffice.”

To that extent, there must be a settled suspicion that money laundering is taking place. Further, the case of R v Anwoir & others provides a further gloss on the definition in Da Silva. In addition to actual knowledge that criminal activity, such as tax evasion or fraud is taking place, it may also be possible that suspicions are aroused by a cluster of warning signs from which the “irresistible inference” must be that the property or funds must be criminal in origin.

What emerges from the case law is a need to be specific about the nature of suspicion. A blanket view along the lines “this feels a bit odd” is insufficient and it is preferable to decide exactly why, in the context of any notification, you are suspicious grounded in the facts and the context. This approach is to be preferred to counter any allegation that a notification was made in bad faith (as was the allegation in Shah v HSBC), and on a purely practical basis it is a requirement of the notification to SOCA in any event.

Primary Money Laundering Offences: s327-s329 POCA
Given training in AML compliance is of a compulsory nature in the regulated sector, most practitioners will be well acquainted with the provisions of the Act. A brief recap does, however, assist in placing the relevant provisions in context.

S327 Offence: Concealing, disguising, transferring criminal property.
This section makes it an offence to conceal, disguise, convert criminal property or remove criminal property from England & Wales. The definition in s327(3) states that concealing or disguising includes “concealing or disguising its nature, source, location, disposition, movement or ownership or any rights with respect to it.”
An offence under this part of s327 cannot seemingly be committed by “mistake” and it is quite a difficult offence to prove satisfactory as it would be necessary to prove the act of concealment or disguise of the criminal proceeds.

S328 Offence: Arrangement Offences.
S328 states that a “person commits an offence if he enters into or becomes concerned in an arrangement which he knows or suspects facilitates (by whatever means) the acquisition, retention, use or control of criminal property by or on behalf of another person.”
5. Client Care

a) Client care requirements of SRA Code of Conduct

The requirement to look after clients and to provide a high level of care is primarily the responsibility of the COLP. However, there are some aspects of this which might be delegated to the COFA. Outcome 1.13 of the Code is an example of this and says:

“Clients receive the best possible information, both at the time of engagement and when appropriate as their matter progresses, about the likely overall cost of their matter”.

One of the most common complaints made by clients is a failure to keep clients informed on the likely cost of a matter. Although a fee earner is aware of this obligation it is very easy to become so involved in a matter that the fee earner forgets to keep the client informed on costs, particularly as the scope and nature of the matter changes. It may well be that the COFA is the right person to assist in this regard as they will often be responsible for the day-to-day running of the finance function within the firm.

This chapter looks at some of the areas where the COFA might be able to provide some support to the COLP.

b) File opening

a. Money laundering, conflicts etc.

Legal businesses need to make sure there are correct procedures in place at the start of the matter to ensure the business does not find itself becoming involved with money launderers. In addition, the business must take the necessary steps to ensure there are no potential conflicts which might arise from taking the instruction. Traditionally, this was seen as a simple administrative task but increasingly the more sophisticated and larger firms are building up a team of people who will deal with these issues in a specialist way.

b. Credit risk of client

There have been too many cases where a file has been opened for a matter which will keep a fee earner busy and interested but which will result in no fee or a heavily discounted fee as the client is not able to cover the costs incurred on the matter. It is important to establish credit control procedures for new clients, as well as for new matters for existing clients.

Every client should be given a credit limit and the financial systems being used should be set to report any clients which are breaching their credit limit. Reports are therefore needed which show the total credit being given to clients as the sum of the following:

i. WIP not billed; and
ii. Unbilled disbursements already paid out of office account; and
iii. Outstanding bills.

If credit limits are set at a conservative level, then questions will be raised sooner rather than later about whether further credit should be permitted. Clearly, one of the best ways of reducing the amount of credit given is to require more money on account of costs, earlier billing and prompt settlement of bills as the matter progresses.

c) Client care letters & terms of business

There are a number of issues which need to be communicated to a client during a matter. Some of these issues will be communicated in a standard terms of business document that leaves other matter specific issues which can be dealt with in a client care letter.

It is important the terms of business letter is always sent and that it cannot be varied as this must cover the items which have to be communicated to the client. Some of the key requirements can be seen by reading the following outcomes in the Code, which deal with client care as follows:
CHAPTER 5 - CLIENT CARE

**O 1.13** clients receive the best possible information, both at the time of engagement and when appropriate as their matter progresses, about the likely overall cost of their matter;

**O 1.14** clients are informed of their right to challenge or complain about your bill and the circumstances in which they may be liable to pay interest on an unpaid bill;

**O 1.15** you properly account to clients for any financial benefit you receive as a result of your instructions;

The Code then provides some Indicative Behaviours which need to be considered as follows:

**Fee arrangements with your client**

**IB 1.13** discussing whether the potential outcomes of the client’s matter are likely to justify the expense or risk involved, including any risk of having to pay someone else’s legal fees;

**IB 1.14** clearly explaining your fees and if and when they are likely to change;

**IB 1.15** warning about any other payments for which the client may be responsible;

**IB 1.16** discussing how the client will pay, including whether public funding may be available, whether the client has insurance that might cover the fees, and whether the fees may be paid by someone else such as a trade union;

**IB 1.17** where you are acting for a client under a fee arrangement governed by statute, such as a conditional fee agreement, giving the client all relevant information relating to that arrangement;

**IB 1.18** where you are acting for a publicly funded client, explaining how their publicly funded status affects the costs;

**IB 1.19** providing the information in a clear and accessible form which is appropriate to the needs and circumstances of the client;

**IB 1.20** where you receive a financial benefit as a result of acting for a client, either:

a. Paying it to the client; or
b. Offsetting it against your fees; or

**IB 1.21** ensuring that disbursements included in your bill reflect the actual amount spent or to be spent on behalf of the client.

It is clearly important that the expectations of the client around the costs of the matter are handled well and this is primarily about clear communication from the start of the matter.

d) **Matter planning, pricing & time recording**

**Matter planning**

If a legal business is going to keep clients informed on costs then the first thing it has to be able to do well is to produce a reliable estimate of costs at the outset. This will require a formalised approach to the planning of a matter. This approach should help the business to identify and clarify the scope of work being done while also communicating the likely cost to the client of the matter.

Legal businesses are increasingly investing in matter planning tools which will help them to do this. The screen shot in Figure 3.1 (p67) is the sort of tool which might be used.

The tool works in the following way:

i. A number of templates are created to cover the most common types of file which a firm opens. Each template will split into a number of phases and sub tasks which show how the work will be done.
ii. Once the template is complete the resourcing can be done. Fee earners at different levels are selected. As they are selected the spreadsheet automatically displays the headline rate and the cost rate per hour of each fee earner.

iii. The spreadsheet now shows what the fee would be (this is what the client is interested in) and what the profit would be (this is what the business should be trying to manage) with a number of different pricing options:

a. Headline rates; or
b. Agreed rates; or
c. Fixed fee; or
d. Blended rate.

iv. To enable work to be completed efficiently, it is also important to think about linking the matter plan into available know how. The spreadsheet tool allows each template to be linked in to existing practice notes, standard documents and checklists.

By using a tool such as this, it helps to be clear with clients about the scope of work being undertaken. If the scope then varies, this should be clear to the client and it will represent additional work that was not covered by the original quote.

The cost of running a matter can be reduced in many ways without reducing the scope of work being done and without diluting the quality of...
Appendix - 2013 Financial Benchmarking Report

A significant analysis of the current legal market

The economy of law firms in the UK is static and more change is on its way. This report tracks the financial data of small to medium-sized law firms from year end 2012 and represents significant analysis of the current legal market.

Among 337 firms, less than half the current head count will generate revenue while income is sidelined for some 104 days in lock-up. Efficiency has never been more important. So how can financial benchmarking keep your legal firm ahead of the rest?

Foreword

This report is delivered by the Commercial Banking Division of NatWest and focuses on the performance of legal firms operating within the small and medium enterprise (SME) space. For the purposes of this report, those firms with fees of less than £1.5 million are described as ‘small’, while those with fees in excess of that amount are described as ‘large’.

In producing this report, the bank has accessed its library of financial data representing the performance of 337 firms, employing 15,200 people in total, and covering year end 2012. The large number of contributions has enabled us to develop a robust cross-section of key performance outputs at both national and regional levels.

With the majority of existing reports detailing outputs from the country’s top 100 legal firms, we wanted to undertake a piece of work that focused on the firms that sit outside this group.

These firms are clearly at the frontline in respect of the operational challenges associated with legal sector reform and the consequences of an economic slowdown that has certainly outstayed its welcome. Our ambition was to report a set of performance measures that are truly reflective of those firms representing the majority of legal firms.

In our experience, too few firms choose to employ financial indicators to influence their pace or direction of strategic travel. Without such indicators, it is unlikely that the leaders of law firms will be in a position to change the behaviours of their people and influence future performance, given the lack of specific performance objectives.

The report identifies many areas of significant differential across common and potentially critical performance measures, including:

- Profit to fees varies from 5% to 54%
- Profit per equity partner (PEP) varies from £11,000 to £459,000
- Year-on-year fee performance varies between 93% and 123%
- Total lock-up varies between 46 days and 184 days

Working alongside Robert Mowbray, we have looked to deliver a survey that can be easily interpreted and employed by legal firms in order to benchmark their own efficiency against that of their regional and national competition.

We hope that the report is of interest, but more importantly enables you to develop and deliver a strategic plan that keeps your legal firm ahead of the competition and fit for business.

In addition to providing access to Professional Sector Relationship Managers who benefit from accredited training and our annual series of CPD-qualifying Legal Conferences, this report forms part of the bank’s ambition to provide specific business support and expertise to the legal sector.

Steve Arundale
Head of Professional Sectors & Financial Institutions, NatWest Business & Commercial Banking
Executive summary

This survey is a substantial review of law firms with fee income of up to about £27 million. Taking part in the survey were 337 firms across England, Wales and Scotland, employing 15,200 people. Their total income was £1.05 billion.

The survey uncovered some notable findings.

Fees
- The fee per equity partner at the median level was £393,000 per annum – 2% up on the previous year.
- The fee per fee earner was a median of £132,000 per annum. The London region at £217,000 was considerably higher than the North at £155,000, while the combined figure for Wales, Midlands and East of England was lowest at £112,000.

Profit
- At £59,000, the median profit per equity partner (PEP) in small firms was exactly half of that in large firms at £118,000. Median PEP across all firms was £90,000. If fair remuneration for an equity partner was £80,000, then it could be observed that the average firm was making virtually no real profit.
- Median PEP was up 18% on the previous year in small firms and increased by 2% in large firms. In total, median PEP increased by 6%.
- A firm with upper quartile performance for gearing, hours recovered rate and margin made a profit of about 10 times more per equity partner than one with lower quartile performance.
- Profit as a percentage of fees saw a median figure of 23% with the lower quartile point at 15% and the upper quartile at 33%. This was in line with pre-recession surveys and showed the legal sector to be in good health.
- One of the key drivers of profitability was gearing: in small firms it was two, while in large firms it was four. Small firms need to think about the development of a larger fee earner base.

Lock-up
- Total lock-up was a median of 104 days but the lower quartile figure was 148 days and the upper quartile was 69 days. The median in Scotland was just 83 days.
- These figures suggest that most firms were not seeing a significant deterioration in cash flow.

Finance
- The median office bank balance at the year end was £17,000, which shows that most firms were not reliant on debt and should have the ability to borrow to invest.
- Partner capital at 27% of fees was providing the finance for work in progress (WIP) and debtors in the median firm.
- The median firm would exceed its overdraft balance in about 40 days if it stopped generating cash from fees.

Introduction

When the financial crisis erupted in 2008, throwing the country into recession, nobody appreciated how long and painful the recovery period would be. Until then, law firms had enjoyed 16 years of unbroken economic growth and it had been relatively easy to increase profits as fee income grew.

Recent analysis has shown that the economy of the UK and the economy of law firms have both become static: there has been no real rise in fee income and most law firms have suffered a fall in profits during this period. There is no real prospect of the situation improving significantly over the next few years and this environment is perhaps the new normal.

We have also seen the arrival of new competitors in the legal market and the advent of the alternative business structure (ABS). This will create further change over the coming years, which will either be seen as a threat or an opportunity for firms, depending on how quickly they can adapt to an evolving legal market.

It is therefore becoming very important for all firms to benchmark themselves against their competitors, in order to assess how well they are...