

ASSESSING THE RISKS

SRA Accounts Rules changes mean greater focus on risk assessment and judgement, says **Louise Sharp**



Accounting firms with law firm clients will be thinking about how the recent changes to the accountant's report requirements by the Solicitors Regulation Authority (SRA) affect the work they perform under the SRA Accounts Rules. This may mean bigger changes for some than for others, depending on the nature of their clients and the work previously performed.

We have set out some markers to help members get to grips with these changes. These were covered in the recent faculty webinar, *SRA Accounts Rules and the role of the reporting accountant*, by Janet Taylor, a specialist on SRA Accounts Rules at Taylor Mowbray and a member of the ICAEW Solicitors Special Interest Group. Detailed interim guidance has also been published in ICAEW Technical Release TECH 16/15AAF (see box, opposite).

KEY CHANGES

Since 1 November 2014, law firms have only been required to submit qualified accountant's reports. Prior to this all accountant's reports were filed with the SRA.

For law firms with financial year-ends ending on or after 1 November 2015, the SRA has introduced two key changes:

- Additional exemptions from the requirement to have an accountant's report for low risk law firms. However, all law firms need a final report if they cease to hold client money - even for moving from a sole trader to a partnership; and
- SRA Accounts Rule 39 has been replaced with Rule 43A.1 and a new accountant's report form ARI.

NEW RULE 43A.1

The old prescriptive testing in Rule 39 has gone, taking with it the reporting accountant's checklist and the requirement to specifically check two reconciliations in detail.

New Rule 43A.1 expects reporting accountants to take a risk-based approach to their work and to their reporting. No sample sizes are given and so reporting accountants must use their judgement to determine the amount of work they need to do as well as what problems identified require a qualification.

Firms should note that the report wording isn't exactly the same as Rule 43A.1. The report wording makes specific reference to material breaches and/or significant weaknesses in the systems and controls for compliance with the Accounts Rules. It also refers to the SRA published guidance - so it is important for reporting accountants to have read this.

While the Accounts Rules remain highly prescriptive, and reporting accountants are still expected to sample check compliance with them, the SRA expects that the volume of qualified reports will reduce as reporting accountants must now consider the 'materiality' of the breach and the 'significance' of the weakness in systems and controls. Gone are the days where all breaches (except those that were deemed 'trivial') were reported to the SRA for the SRA to determine where the risks to client money lay. The reporting accountant must now determine these risks.

WHISTLEBLOWING

There is a new duty to report to the SRA if the reporting accountant discovers a failure by the law firm to submit a previously qualified report.

Reporting accountants will need to update engagement letters to deal with these changes (Rule 35 is still relevant

here) and they will also need to retain these terms for six years now.

ASSESSING RISK

As we highlighted in TECH 16/15AAF, the SRA doesn't expect the new requirements to increase the role of the reporting accountant and has pointed to the historical evidence indicating how rare it is for the SRA to take action against a reporting accountant.

However, if you are a reporting accountant who hasn't really considered risk assessment before on these engagements you are going to need to rethink your approach here. The reporting accountant should focus on the following:

- the risk of material breaches and significant system weaknesses by the law firm; and
- the risk that the reporting accountant doesn't carry out the work and report to the SRA appropriately.

TECH 16/15AAF highlights example risk factors in law firms that reporting accountants should be thinking about and their assessment of risk will need to be clearly documented.

PERFORMING THE WORK

Substantive testing is still likely to be a significant part of the work procedures performed as the SRA is not expecting reporting accountants to move to just a controls-based approach. Reporting accountants should therefore be thinking about the order in which the work is performed. Both the webinar and Technical Release give more guidance here, including possible higher or lower risk areas.

MATERIAL OR SIGNIFICANT?

The nature of the breach/control weakness may be far more important than the amount. The SRA's guidance gives a list of serious factors that are likely to be deemed reportable and also moderate factors that may lead to a qualification. Reporting accountants need to think about the type of breach/weakness, how and why it arose, number of instances, amount and how they have been dealt with by the law firm.

One particular concern among reporting accountants is the reference to significant weaknesses in systems and controls. "Although the ARI asks the reporting accountant to report any significant weaknesses in the firm's systems and controls this has to be considered in relation to the size of the firm", says Taylor.

Long gone are the days where all breaches were reported for the SRA to determine where the risks lay. The reporting accountant must now determine these risks

"Signing off on this without qualification does not mean that the reporting accountant has formed the view that there are no risks, merely that given the size and nature of the firm the system they have is reasonable." For example, a sole practitioner solicitor with a part-time bookkeeper is unlikely to have a myriad of internal procedures to authorise payments and it would seem unlikely for a reporting accountant to qualify on these grounds alone. What is more important here is whether breaches have occurred and if they are material.

The clear message is that if a reporting accountant does not think that something is reportable then they will need to document why.

EXERCISING JUDGEMENT

The reporting accountant ultimately needs to demonstrate that he/she has sensibly exercised his/her judgement. To help, reporting accountants may want to ask themselves the following questions:

- Have you used people with the appropriate skills and training to do this work?
- Can you demonstrate that the work has been appropriately planned?
- Did you properly consider the risks and can you demonstrate that the work performed relates back to the risks identified?
- Where relevant, have you had a robust internal review process and second partner/hot partner review?
- Can you demonstrate that there is evidence on file to support the conclusions reached?

The SRA's move to a more risk-based approach gives reporting accountants plenty to think about. ■

GUIDANCE AND SUPPORT

Solicitors Regulation Authority (SRA) guidance is available at sra.org.uk/ar1 ICAEW Technical Release TECH 16/15AAF *SRA Accounts Rules: interim guidance for reporting accountants following changes to the accountant's report requirements* is at tinyurl.com/AB-TechRel

To listen to the recent Faculty webinar visit tinyurl.com/AB-Webinars