



Client Money Newsletter

February 2021

Edited by Roger Morris

HAT
Group of Accountants

GUIDANCE FROM SRA IN RESPECT OF COMPLIANCE DURING COVID-19 OUTBREAK

The Solicitors Regulation Authority (“SRA”) has issued guidance in a number of areas, which summarises some of the most common queries they have received from solicitors about their rules and the potential impact of coronavirus. Those regarding the SRA Accounts Rules (for which this is a summary of the commentary on the SRA’s website) cover:

DELAY IN COMPLETION OF ACCOUNTANT’S REPORT

These are exceptional circumstances and the SRA takes a pragmatic and proportionate approach to any delay in preparation of an accountant’s report. If there are good reasons for a reporting accountant needing longer to prepare a report because of the impact of the coronavirus - which takes a firm outside of the six months window – the SRA would not take any subsequent disciplinary action.

If a firm has delayed getting their accountant’s report because of the coronavirus, the SRA would not ordinarily view that as a serious breach that needs to be reported by the COFA, however, the COFA should clearly document the reasons for any delays and the approach they and their reporting accountants have taken.

GUIDANCE ON THE WORK OF A REPORTING ACCOUNTANT

The SRA’s guidance sets out the work which might need to be undertaken by the accountant and the sorts of factors which might lead the accountant to decide that the report should be qualified, and they have concluded that no amendment to this guidance is required. HAT concurs with this conclusion, as the Reporting Accountant should consider risks arising from the handling of client money and perform procedures to address those risks, with conclusions on qualification being based on the R.A.s judgment.

The R.A. must, however, comply with their statutory duties and report to the SRA immediately if there are any concerns about the theft of client money or dishonesty.

FIVE WEEKLY RECONCILIATIONS

Five weekly reconciliations are a key part of making sure the solicitor is protecting clients’ money. If there are any differences shown by the reconciliation, managers are under an obligation to promptly investigate and resolve any issues. Firms should therefore have contingency plans in place to make sure reconciliations are completed, but if these fail because of the impact of coronavirus, all necessary steps should be taken to ensure that client money is being dealt with properly, with the approach and all decisions being fully documented.

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INABILITY TO BANK CHEQUES PROMPTLY

A solicitor should promptly pay (in all circumstances) client money into its client account. If incoming cheque receipts are delayed because of the impact of the coronavirus on a firm or its bank, the client should be kept updated as to the position and any decisions made should be documented. The SRA will take all of the circumstances into consideration if it receives a complaint and would be unlikely to conclude that there has been a breach of their rules in this situation. However, electronic payments could be requested to avoid such delays arising.

CHANGE TO METHOD OF SUBMISSION OF QUALIFIED REPORTS TO THE SRA

The SRA have advised that any qualified Accountant's Report after 30 September 2020 can only be submitted to them through a mySRA account. This change was not widely publicised by the SRA, with a commentary being provided by the [ICAEW's Solicitors Special Interest Group](#), which states:

"Traditionally, qualified accountants' reports were submitted via email to the SRA in the form of a completed AR1 and any appendices. However, the SRA has recently changed their system for filing qualified reports, which should now be submitted through a mySRA account.

The new system requires the individual submitting to select the rules which have been breached and to provide information on each individual breach. The SRA confirmed that this should include the same level of detail previously provided with the AR1 and any appendices relating to the breach. There is no need, for example, to append copies of ledgers, statements etc. The system allows users to generate a printable copy of the submitted form, including confirmation of which documents were uploaded, as well as the declaration made by the submitter.

While it remains the responsibility of the law firm to file the report, in the past, reporting accountants have often filed these reports on their behalf. The SRA still allows for this in the future and clarified that reporting accountants can set up mySRA accounts to submit qualified reports on behalf of law firms."

GUIDANCE FROM FCA REGARDING COMPLIANCE DURING COVID-19 OUTBREAK

The Financial Conduct Authority ("FCA") issued a number of "Dear CEO" letters during 2020, along with a summary of recurring queries received during the COVID-19 outbreak and how firms should take steps to address these. [Their website reflects all of this in a single location](#) and it includes:

"DEAR CEO LETTERS:

These Dear CEO letters highlight the areas that are important to maintaining adequate client assets arrangements in the current environment:

- » [Dear CEO letter: Adequate client assets arrangements](#) (for firms holding client assets relating to investment business, debt management or claims management); and
- » [Dear CEO letter: Adequate client assets arrangements GII](#) (for firms holding client money relating to insurance distribution).

These letters are relevant for all firms which hold client money and / or custody assets. Firms should consider carefully which sections apply to their arrangements. The continued impact of the [coronavirus](#), combined with other key events, such as the end of the EU withdrawal transition period, mean that FCA regulated entities are being affected in ways that would have been difficult, if not impossible, to predict previously.

Firms should review their client assets arrangements in the specific areas set out in the letters, considering the current economic environment. Where deficiencies are identified, firms should take immediate action to rectify them. The FCA also expects firms to notify them of any material concerns identified while reviewing the adequacy of their client assets arrangements.

These letters are in addition to the letters recently issued on:

- » [Dear CEO letter: Inappropriate use of Title Transfer Collateral Agreements;](#)
- » [Dear CEO letter: Increased client money balances;](#) and
- » [Dear CEO letter: Senior Partner / Director of the audit firm – Reporting obligations.](#)

SUMMARY OF QUERIES RECEIVED ON CASS COMPLIANCE RELATING TO COVID-19 OUTBREAK

HANDLING CHEQUES

Firms have noted some difficulties being caused by cheques being delivered to unmanned offices and remaining unbanked.

Clients send cheques to firms for a variety of reasons. The FCA expects firms to consider potential harm caused by not being able to cash the cheque on a case-by-case basis – for instance, whether it means that the customer cannot receive the product or service intended until the cheque is cashed. Firms should communicate clearly with clients on this.

WHERE A CHEQUE REPRESENTING CLIENT MONEY IS NOT PAID INTO A CLIENT BANK ACCOUNT PROMPTLY, THERE ARE TWO MAIN ISSUES FROM A CASS PERSPECTIVE

- » The CASS rules generally require a firm to bank a cheque into a client bank account within one business day and in the interim before banking the cheque to hold it securely and record its receipt. Where there are logistical difficulties in relation to these requirements arising from coronavirus, it is expected that firms take such mitigatory steps as are possible in the circumstances, to ensure that clients assets remain protected; and
- » If payment is made out of a client bank account for a client who has paid using an (unbanked) cheque, this will usually breach the CASS rules. But when a firm subject to CASS 5 or CASS 7 is aware of clients who have paid by cheque and acts upon their payment instructions without having banked the relevant cheque, it is not a breach if the firm has previously paid an amount of its own money into a client bank account, in line with CASS 7.13.41R - CASS 7.13.53R (for investment firms) or CASS 5.5.10R (for insurance intermediaries). Insurance intermediaries operating a non-statutory client money trust under CASS 5.4 may not be affected by this issue, as credit can be advanced from the non-statutory trust where the trust deed allows for it in accordance with CASS 5.4.8R(1).

Otherwise, to act upon the client's payment instruction without breaching the CASS rules, the firm should:

- » Ask the client to make a payment directly into the client bank account by alternative means before completing the instruction; and
- » Return or destroy any cheque received in line with the client's instructions.

CASS AUDIT REPORTS

Some firms are concerned the current situation could lead to additional breaches needing to be reported and costs of the CASS audit reports could increase.

CASS auditors usually group multiple breaches in their reports, avoiding the need for extensive repetition and additional cost. The FCA has not heard from auditors that reporting on extra breaches would result in significantly increased costs of audits.

If an audit firm subject to SUP 3.10.4R is not able to submit a particular CASS audit report to the FCA within the 4-month deadline (SUP 3.10.7R), it should follow the 'late reporting' rules in SUP 3.10.8, sending an email to CASSAudit@fca.org.uk setting out:

- » The name and FRN of the regulated firm;
- » The period covered by the audit report;
- » A full account of the reasons for the delay; and
- » When it expects to be able to report.

If the audit firm is aware of any significant matters with the firm's CASS compliance, it should also notify the FCA by emailing CASSAudit@fca.org.uk. This is under the 'statutory duty to report' referred to in SUP 3.8.10 and set out in The Financial Services and Markets Act 2000 (Communications by Auditors) Regulations 2001 (SI 2001 / 2587).

PHYSICAL ASSET RECONCILIATIONS

Some firms subject to CASS 6 have reported difficulties reconciling physical safe custody assets as they cannot access the location where the assets are held.

CASS 6.6.22 R requires a firm to reconcile physical safe custody assets as often as is necessary and, in any event, every 6 months. Where there are logistical difficulties in relation to this requirement arising from coronavirus, the FCA expects firms to take such mitigatory steps as are possible in the circumstances, to ensure that clients assets remain protected. CASS 6.6.57 R (5) requires a firm to notify the FCA if it is unable to conduct a physical asset reconciliation.

DEPOSITING CLIENT MONEY

Some firms subject to CASS 7 have noted that an increase in client money holdings may lead to some operational challenges in terms of meeting segregation and diversification requirements. The rules in CASS 7 specify that client money can be deposited in accounts opened with any of the following:

1. A central bank;
2. A CRD credit institution;
3. A bank authorised in a third country; or
4. A qualifying money market fund.

Firms should continue to follow the rules on diversifying holdings in CASS 7.13. If a firm is experiencing any challenges in being able to segregate money, the FCA expects it to have assessed the options available to it in detail before contacting them.

NOTIFICATION OF CASS BREACHES

Firms may be required to notify the FCA of CASS breaches under Principle 11 and SUP 15. In addition to these general duties, the CASS rules contain various requirements to notify them of specific issues (for example if a firm is unable to carry out a reconciliation or unable to pay any shortfall into a client bank account).

These specific requirements in CASS relate to fundamental components of the regime and firms should continue to make any notifications required under CASS.

CASS FIRM CLASSIFICATION

Some firms have reported increased holdings of client money and / or custody assets.

The rules in CASS 1A.2.2 R and CASS 11.2.1 R require certain firms to categorise based on the value of client money and / or assets held during the previous calendar year (ending on 31 December 2020).

Firms should continue to operate as normal and notify the FCA of their categorisation in January as usual."

FILING EXTENSION FOR FCA REGULATED, UNLISTED COMPANIES

Given the impact of coronavirus (COVID-19), the FCA has introduced some temporary measures for firms submitting regulatory returns, which state:

“Due to the challenges faced by firms and their auditors preparing audited financial statements during the coronavirus pandemic, the FCA will allow flexibility in the submission deadline for FIN-A (annual report and accounts). For this return only, firms may apply a 2-month extension to the deadline for submissions due up to and including 31 July 2021.

Firms should note this flexibility is intended to cover the situation where the impacts of coronavirus have made it impractical to finalise audited financial statements. If firms are able to submit FIN-A on time, then they should do so – and in any event should submit it as soon as they are reasonably able to and no later than 30 September 2021.”

Details of other returns for which the FCA has granted an extension can be viewed on their website.

FCA CONSULTATION REGARDING NEW PRUDENTIAL REGIME FOR UK INVESTMENT FIRMS

The FCA, during 2020, published a discussion paper on a prudential regime for UK investment firms. Its Press Release states:

“This marks the first step in introducing a set of prudential rules for investment firms to better reflect their business models and the risk of harm they pose to consumers and markets.

A new UK regime would represent a significant improvement in the prudential regulation of investment firms. For the first time, it would deliver a regime that has been designed with investment firms in mind.

The information in the Discussion Paper will be of interest to all solo-regulated investment firms that are currently authorised under MiFID. It will also be of interest to Collective Portfolio Management Investment Firms and those investment firms authorised by the Prudential Regulation Authority.”

REVISED CLC ACCOUNTS CODE

The Council for Licensed Conveyancers (“CLC”) have confirmed that their revised Accounts Code has now been approved by the Legal Services Board and that the revised Code and Guidance can be found on the CLC’s website and it is summarised that:

“A revised accounts code will be coming into effect on 30 September 2020.

The new code will contain simpler, more targeted requirements to make the code easier to understand, improving compliance and consumer protection.

The main changes are in relation to how to deal with aged balances up to £50 and to allow the use of third-party managed accounts (TPMAs):

- » CLC practices will now have greater flexibility in the management of aged balances up to £50 if they are unable to identify the rightful recipient; and
- » CLC firms will only be able to use TPMAs regulated by the Financial Conduct Authority, and firms must also be authorised by the CLC to enter arrangements with a client to use a TPMA.

You can see the revised code here, the aged balance guidance here and, the TPMA guidance here.”

HAT COURSE DATES

To ensure that all members of your team who deal with assurance assignments in respect of client money are fully trained, HAT will be running the following CPD courses:

- » [Introduction to SRA Accounts Rules Assignments ~ Wednesday 10 March 2021](#); and
- » [Applying the New SRA Accounts Rules One Year On ~ Tuesday 23 March 2021](#).

These CPD courses will be running online, or may alternatively be run, “in-house” for a firm on a mutually convenient date during 2021.

Additionally, it is possible for CPD courses relating to Service Charges, Property Agents’ Client Money, and Insurance Brokers’ Client Money to be provided, subject to demand.

For details of our charges and availability, please contact Roger Morris at the HAT Office at roger@hatgroup.co.uk.

HAT ASSURANCE MANUALS

HAT SRA ACCOUNTS RULES MANUAL

Two updates were issued during 2020.

Initially, following guidance issued by the ICAEW on the conduct of SRA Accounts Rules assignments following the 2019 changes, TECH 03/20 AAF prompted some minor amendments to the HAT SRA Accounts Rules Manual (November 2019), which were as follows:

- » Reflecting TECH 03/20 AAF as being current guidance for such assignments;
- » Enhancing wording in the letter of engagement;
- » Enhancing tests on the Client Accounts work programme covering suspense accounts and writing off of old balances;
- » Highlighting that when the Accountant’s Report indicates that the solicitor has rectified control / system weaknesses that, if these have not been verified, this fact is included within the Accountant’s Report; and
- » Highlighting that as SRA guidance will evolve over time that the Reporting Accountant should always have regard to the current SRA guidance.

Subsequently, for any accounting period which commenced on or after 25 November 2019, it is only necessary to report on compliance with the SRA Accounts Rules 2019, the HAT SRA Accounts Rules Manual (November 2020) has been released for these accounting periods, with the following being reflected within this Manual:

- » The removal of any requirements of the SRA Accounts Rules 2011; and
- » In the absence of wording from the SRA to be included in the letter of engagement (although whistleblowing wording previously included within Rule 35, SRA Accounts Rules 2011 was substantially driven by the Solicitors Act 1974, section 34 (9)), this has been re-engineered as an Appendix to the letter of engagement, worded from the Reporting Accountant to the legal practice to reflect the style in all HAT Manuals.

For Accountants Reports to the Council for Licensed Conveyancers (“CLC”), guidance within the Licensed Conveyancers Supplementary Manual is included within the HAT SRA Accounts Rules Manual (November 2020):

- » The CLC has made similar amendments to their Accounts Code as have been made by the SRA and these came into effect on 30 September 2020. Care should be taken to ensure that any engagement for an Accountant’s Report to the CLC considers compliance with the correct version of the Accounts Code before / after 30 September 2020; and
- » As the CLC will be dual running with two versions, it should be ensured that the correct Accountant’s Report is completed and submitted to the CLC, with any Accountant’s Report submitted on or after 31 March 2021 needing to be in the new format.

HAT FCA CLIENT ASSETS REPORTS MANUAL

The FRC's revised Client Asset Assurance Standard (November 2019) is mandatory for accounting periods commencing on or after 1 January 2020 (with no ability for the amendments to be adopted for a prior accounting period). The updated HAT FCA Client Assets Reports Manual (January 2020) should therefore be utilised for all such accounting periods.

The following are the main changes made in this update:

FRC CLIENT ASSET ASSURANCE STANDARD (REVISED)

The majority of the enhancements required as a result of the revision to the FRC Client Asset Assurance Standard are minor and all have been fully reflected within the updated Manual.

The only reduction is that an EQCR is a mandatory requirement solely for a reasonable assurance assignment on a Large / Medium CASS investment business firm. It is recommended on all other reasonable assurance assignments (Assurance Standard, Paragraphs 137 / 139).

The Manual can be "early adopted" so long as an EQCR is performed on all reasonable assurance assignments and the relaxation of this requirement is not applied to an earlier period for which it is not available.

CASS 13: CLAIMS MANAGEMENT – CLIENT MONEY

With effect from 1 April 2019, the Financial Conduct Authority became responsible for regulating claims management companies. The basis on which claims management companies handle client money is set out in CASS 13.

SUP 3.1 requires a Client Assets Report to be obtained by all claims management companies.

Documentation is included within the HAT Client Assets Reports Manual (January 2020) covering CASS 13 assignments (noted by a suffix of "CM" within documentation) and this can be utilised with immediate effect. However, as noted above, it should be ensured that for all reasonable assurance assignments for a claims management company, where the accounting period commences before 1 January 2020, that an EQCR is performed.

IMPORTANT NOTE

With regards to this Newsletter, every care has been taken by HAT in the preparation of these articles, HAT does not guarantee the accuracy or veracity of any information or opinions. No responsibility for loss occasioned to any person acting or refraining from acting as a result of material contained within these articles can be accepted by the editor, HAT, its officers or employees.

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