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LEGAL FINANCE PROFESSIONALS

Residual Client Balances Information Sheet

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Residual Client Ledger Balances: Do You Have a Skeleton in the Closet?

Introduction

There are very few firms of solicitors that do not have a problem, to a greater or lesser extent, with old residual balances on their clients' ledger. For many, these balances may only be a few pounds or even a matter of pennies but, even so, they can create very real compliance problems under the SRA Accounts Rules.

What the Rules Say

It may seem strange but until the old version of the rules, the Solicitors' Accounts Rules 1998, were amended on 14 July 2008, there were no direct provisions within the accounts rules that required solicitors to return money to clients on the conclusion of a matter, even when those funds were not needed for any other purpose. However, those who failed to do so were taking a risk as the Solicitors Regulation Authority (SRA) always had the option of making a regulatory case against the solicitor or firm on the grounds of misconduct, usually for failing to act in the best interest of their client and/or bringing the profession into disrepute.

On 14 July 2008 various amendments were made to the accounts rules with the intention of making it easier for solicitors to deal with residual client ledger balances under £50 by allowing these, subject to satisfying certain conditions, to be paid directly to a charity without having to seek a waiver from the SRA in the first instance. But, as is often the case, there was a sting in the SRA's tail. Other changes introduced new provisions which, for the first time, created a requirement to account to clients 'promptly' at the conclusion of a client's matter.

In the new version of the SRA Accounts Rules, introduced on 6 October 2011, the relevant provisions are contained within Rule 14.3, Rule 14.4 & Rule 20.2 and are as follows:

Rule 14.3

Client money must be returned to the client (or other person on whose behalf the money is held) promptly, as soon as there is no longer any proper reason to retain those funds. Payments received after you have already accounted to the client, for example by way of a refund, must be paid to the client promptly.

Rule 14.4

You must promptly inform a client (or other person on whose behalf the money is held) in writing of the amount of any client money retained at the end of a matter (or the substantial conclusion of a matter), and the reason for that retention. You must inform the client (or other person) in writing at least once every twelve months thereafter of the amount of client money still held and the reason for the retention, for as long as you continue to hold that money.

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Rule 20.2

A withdrawal of client money.....may be made only where the amount held does not exceed £50 in relation to any one individual client or trust matter and you:

a) establish the identity of the owner of the money, or make reasonable attempts to do so;

b) make adequate attempts to ascertain the proper destination of the money, and to return it to the rightful owner, unless the reasonable costs of doing so are likely to be excessive in relation to the amount held;

c) pay the funds to a charity;

d) record the steps taken in accordance with rule 20.2(a)-(c) above and retain those records, together with all relevant documentation (including receipts from the charity), in accordance with rule 29.16 and 29.17(a); and

e) keep a central register in accordance with rule 29.22.

The Problem

Our experience indicates that, despite the fact that the revised rules have been in place for almost four years, there remain many firms that have yet to grasp the nettle and do anything about the ongoing build-up of residual balances on their firm's ledgers.

Many within the legal sector seem to view this as a low risk area. However, a recent regulatory settlement highlights the importance of dealing with these matters properly. In summary, the firm in question had an historic issue with residual balances and held such balances in a suspense account on the clients' ledger. When the SRA visited the firm in January 2010, the balance on this suspense ledger amounted to just under £20k. The firm had failed to deal with the balances as and when they arose and, in the SRA's view, inadequate attempts had been made by the firm to distribute these funds to clients. The partners were required to give an undertaking to deal with the matters properly, in accordance with the SRA Accounts Rules, and have had to pay fines and costs totalling £12,000.

This case only seeks to highlight the importance of having robust internal accounting controls and procedures designed to prevent residual balances occurring in the first instance.

The Solution

Frequently, on closer examination, the majority of firms will find that the profile of residual balance ledgers will mean that a significant proportion of the ledgers contain relatively small balances. If this is the case, the proper application of rule 20.2 will allow most of these balances to be dealt with fairly easily. Fortunately, although the provisions of Rule 20.2 are relatively new, having been introduced first on 14 July 2008, they can be applied to balances whose origins predate the introduction of the rule.

Balances of £50 or less

In the first instance, you should always try to return funds to the client to whom they belong. The Law Society has issued guidance suggesting that for balances of less than £4, amounts due to the client should be repaid by sending postage stamps of the appropriate value to the client. Of course, this will only be possible where you know the client's current postal address. If this is not known, reliance can be placed on rule 20.2(b) which provides a 'get out' clause where the reasonable costs of ascertaining the whereabouts of a client and returning clients' money to the rightful owner is excessive in relation to the amount held. Where the balance held is less than £4 and you do not know the client's current address, the costs of trying to trace the client would certainly be considered to be excessive and the balance can be paid to a suitable charity.

There has been very little guidance issued by the SRA on the proper application of rule 20.2. The provisions of the rule are subjective and, to an extent, open to different interpretation. When advising clients, our view is that rule 20.2 can be interpreted rather more liberally than suggested by the Law Society's guidance. For bal-

ances of less than, say, £15 which have been in existence for 12 – 18 months or more we would argue that the costs associated with retrieving a client matter file from archive, raising a covering letter and client account cheque is likely to be significant given the amount involved and we believe a firm would be justified in paying such balances to a suitable charity.

For residual balances of between £15 and £30 in amount, we would recommend that a firm should send a client account cheque for the amount of the residual balance to the client's last known address. If this cheque remains unpresented after a reasonable period, say, three months, the cheque should be cancelled and the balance paid over to a charity.

Where the residual balance exceeds £30 but is not more than £50, as before, a client account cheque for the amount of the residual balance should be sent to the client's last known address. However, in this instance where the cheque remains unpresented, the amount involved would suggest that additional steps should be taken to confirm the validity of the client's address. A service such as that offered by 192.com, provides a quick and cost effective method of checking a client's details against the electoral roll, official telephone directory and Companies House records. If this search reveals a different address for the client concerned, the original cheque should be cancelled and a replacement cheque sent to the newly discovered address. However, if a more up-to-date address cannot be found and the cheque is not presented within a reasonable period of time, the cheque should be cancelled and the balance paid over to a charity.

Residual balance monies have to be sent to a charity, however, it does not have to be a charity that gives a guarantee to return monies to the client if they should come forward in the future. Other considerations to bear in mind include the requirement to ensure that a central register is maintained which details the name of the client or other person/trust on whose behalf the money is held, the amount, the name of the recipient charity and the date of the payment. Additionally, copies of receipts from the charity should be retained.

On a final note, for residual balances of £50 or less, where you are unsure whether you have fulfilled the necessary requirements prior to the release of monies, you may still apply to the SRA for authorisation.

Balances over £50

Once the amount of the residual balance exceeds £50, there is no option other than to seek a waiver from the SRA prior to withdrawing the funds from your client bank account under rule 20.1(k) of the SRA Accounts Rules.

Before making an application you need to ensure that you have made every reasonable effort to trace the client. Guidance issued previously by the SRA, indicates that they would expect you to:

- use the Department of Work and Pensions letter forwarding service in order to try and make contact with the client;
- instruct an enquiry agent and/or place a newspaper advertisement where the amount due to a particular client exceeds £200.

Also, remember that any monies due to a dissolved company will, most likely, be bona vacantia and, therefore, properly due to the Treasury Solicitor under the provisions of the Companies Act.

When making an application to the SRA, a firm will need to advise the SRA of:

- the amount(s) in question
- the length of time that the money has been held
- what attempts have been made to contact the client, or evidence that the reasonable costs of doing so are likely to be excessive in relation to the money held.

Depending on the circumstances, the SRA may also require that your accountant provides a let-

ter of verification in support of your waiver application.

As part of your waiver application, you will need to give the SRA an indication of the proposed destination of the money. Normally, waivers are only granted where it is intended to pay the money to a charity although, exceptionally, this may not always be necessary. When granting authority to withdraw client money from the client account, it is more than likely that the SRA will impose a condition that the money is paid to a charity which gives an indemnity against any legitimate claim subsequently made in the future. A growing number of the larger, well known charities, offer such an indemnity.

Avoiding Residual Balances in the Future

Going forward, it is important to ensure that your firm's systems and controls are sufficiently robust to avoid problems with residual balances building up in the first instance. For the firm's prospective COFA, residual balance problems are likely to feature prominently on their risk analysis and will need to be reported to the SRA. Ensuring that finance staff and fee earners have adequate knowledge of the requirements of the SRA Accounts Rules through the provision of appropriate training is an important first step.

Frequently, it is the simple controls and procedures which are the most effective in avoiding the build up of residual balances. For example, providing fee earners with a matter listing detailing those files where there has been no movement on the ledger for a period of, say, three months and requiring an explanation from them will focus their minds on the issue. Some firms build file closure efficiency measures into their appraisal systems to good effect.

Do you Need Further Help?

At Legal Finance Professionals Limited, we can provide you with the support and assistance you need to deal effectively with residual balances and other SRA Accounts Rules compliance issues. To find out more about the training and consultancy services we can provide to support your firm please contact Richard Lane on 0845 6500 112.

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About Us

Legal Finance Professionals Limited was established by Richard Lane in 2007. Richard, a Chartered Accountant, moved out of private practice to join the Law Society's Forensic Investigation Unit in 1996 and has a wealth of experience in the regulatory and compliance sector.

Legal Finance Professionals Limited provides SRA accredited CPD training courses to the legal sector offering a full schedule of public courses throughout England & Wales or via in-house training.

Our courses cover a range of regulatory and compliance topics including SRA Accounts Rules, SRA Handbook, Acting as a Compliance Officer for Finance and Administration (COFA), VAT for Solicitors and Money Laundering Regulations 2007.

The company also offers advice and guidance to firms of solicitors on regulatory compliance issues ranging from a full SRA Compliance Health Check inspection to assisting firms or individuals who find themselves in difficulty with the SRA.

For further information on the services we offer please visit our website or call us now on 0845 6500 112.