



# THE LAW SOCIETY OF SOUTH AUSTRALIA

## MEMORANDUM

**TO:** Mr Tony Abbott  
Ms Margery Nicoll  
Mr Harold Cottee

**FROM:** Richard Mellows, President

**DATE:** 14 December 2009

**SUBJECT:** COAG National Legal Profession Reform Project  
Discussion Paper: Trust Money and Trust Accounting

Please find below the Law Society of South Australia's comments in relation to COAG's Discussion Paper on Trust Money and Trust Accounting.

Comments are limited to those matters where the Society feels further comment is warranted at this time and to draw to the attention of the Taskforce matters the Society considers worthy of further consideration.

### **Regulations vs Rules**

We are concerned that the discussion paper mostly refers to trust money and trust accounts by way of Rules, although in several places it refers to Regulations as an alternative. We regard it as vital that these important requirements have legislative force and must be set out in Regulations which are enforceable in law, rather than having the force of mere Rules.

### **Powers of the Board**

The Society does not consider it appropriate that the Board should be concerned with day to day activities such as supervising law practices in their dealing with trust money and trust accounts. The Power of the Board should be to develop Rules in relation to investigations, external examinations and external interventions to facilitate a consistent and uniform approach by jurisdictional regulators.

The use of the word "investigation" instead of inspection is heavy handed and likely to engender anxiety in the profession unnecessarily. However, as this term is already ensconced in the National legislation in every other State we realize it will be preferred.

### **Proposed regulatory principles**

#### ***Principle 1 – Receipt of Trust Money***

We note that authority to receive trust money vests with a practice where the principal holds a practising certificate authorising the receipt of trust money. This qualification is inappropriate and inconsistent with

the view formulated at the Conference of Regulatory Officers in Perth in September 2009 where an effort was made to limit the number and types of practising certificates. It should be sufficient that being the holder of a principal's practising certificate is authority to receive trust money.

In addition, the definition of trust money as "...money entrusted to a law practice *in the course of, or in connection with the provision of legal services*" is vague and unhelpful. How much of a "connection" must there be? If a solicitor administered an estate for the executor and then retained funds for a further period after the legal work was complete, do these funds remain trust money under this legislation? This is a significant problem area currently, and will rather be exacerbated than clarified if this definition is adopted.

### ***Principle 3 – Obligation to report irregularities***

The Discussion Paper at Principle 3 proposes an obligation for any person dealing with trust money to report any known or reasonably suspected irregularity to the National Legal Services Board. We believe any notification should be to the appropriate jurisdictional agency rather than to the National Board.

How will "irregularity" be defined? If it is defined very broadly then this would involve the Board in a morass of detail which would be quite inappropriate. Do they seriously want a report every time a client inadvertently breaches the regulations e.g. accidentally deposits a payment of a bill into Trust instead of office? These compliance issues should not go to the Board but should continue to be dealt with at the local level. It may be appropriate that only instances of actual or possible serious "irregularities" involving dishonesty or possible fraud be reported to the Board.

Approved deposit institutions should continue to be required to report irregularities.

### ***Principle 4 – Failure to comply***

It is sensible to ensure consistent penalties across the nation for non-compliance, if indeed penalties are to be retained. We note that non-compliance is not currently prosecuted and it is the recommendation of the Consultative Committee to remove the first sentence containing the penalty provision from the Principle. However we agree that breaches of the compliance requirements should, where appropriate, continue to be capable of constituting unsatisfactory professional conduct or professional misconduct.

### ***Principle 6 – Investigation and intervention powers***

Unless it is the intention of the Board to establish offices in every jurisdiction it is impractical for the Board to assume responsibility for practical hands on matters such as investigations, external examinations and interventions. The role of the Board should be limited to ensuring that the legislation authorising such matters is consistent in both form and application across all jurisdictions. This would be a positive contribution to this area of regulation and would assist in streamlining the whole process. The Board could be an arbiter in determining regulatory responsibility in instances of inter-jurisdictional practice by a firm. This again would be a positive contribution by the Board.

## **Specific issues to be addressed by a uniform national approach**

### ***Consistency of situations when trust account provisions do not apply***

We support a consistent approach and for that to happen some jurisdictions may need to suffer changes to the Rules. We do not support different regimes for the operation of a trust account. If a law practice is entitled to receive trust money then the same regulatory requirements should be equally applied to all. We

do not support a regime which grants discretions from compliance. We do not support the concept of barristers being entitled to receive trust money without any requirement for some form of accountability which is consistent with the Principles (for example, by way of exemption).

Consistency but not at the price of equality.

### ***Whether money is “trust money” for the purposes of the Act***

We support any action which expeditiously removes any doubt and ambiguity in relation to trust money. Reference to a court or administrative review appears to be an expensive and dilatory process. Reference of such matters to the Board is desirable. We consider that any Rules should include a time limit in which the Board must make a determination – for example, within 5 working days.

### ***Responsibility for compliance with trust money and trust account provisions***

The Model Bill in our view was flawed when it placed the onus on former law practices. A law practice is a concept comprising natural persons (possibly corporations represented by directors) some of whom are lawyers with certain responsibilities especially where they are principals of a legal practice. This ideology should not be permitted to be carried forward into the National Laws. The concept is simple. It is principals and former principals who are and remain liable for compliance with the trust account requirements of any law practice of which they are or have been a principal. We appreciate the language is not pretty but the concept is clear.

The principals of a law practice must be, and remain, jointly and severally liable for compliance, as set out here. However we are concerned about the use of the term “legal practitioner associate” and indeed “non-legal practitioner associates” and the obligations sought to be imposed on them regarding compliance. This is unnecessary and onerous.

Further, we note there is no immunity provided for employees. If the obligation being imposed is intended to encourage a staff member to be a “whistle-blower” if they see something that appears to be wrong, a corresponding immunity should be provided, as it certainly needs to be for trust account investigators. Neither the South Australian legislation presently, nor the discussion paper contains such an immunity.

### ***Jurisdictional differences***

As stated previously some jurisdictions may have to forgo current arrangements in the interests of true national uniformity. We look to the Board to make Rules for the consistent and equal application of trust accounting requirements across all fields of practice and all jurisdictions. The uniform approach was tried and didn't work as jurisdictional differences were permitted giving rise to idiosyncrasies in some jurisdictions.

### ***Accounting Procedures***

Any new National Rules should not be formulated so as to significantly dilute the current statutory requirements for receiving trust money and operating a trust account. The desire is for the National Rules to be consistent in application and this would allay concerns of practices which operate in more than one jurisdiction or even multiple offices of a practice within the same jurisdiction. We express reservations about forcing a sole suburban practitioner to computerise to an extent sufficient to ameliorate the desires of the large law firms to do everything electronically. At around \$6,000 per annum for the simpler programs, this would be unfairly discriminatory against sole operators and small practices.

However, we endorse any move toward permitting provision of information (such as pre-investigation information and records) and lodgement of documents (such as external examination reports) in an electronic form.

### ***Reporting obligations***

It is imperative for those organisations, most of whom have a regulatory function, to know about the opening and closing of trust accounts as these organisations have statutory responsibility for interest received from trust money. The duty to notify regulators is not onerous and in most instances is not required so frequently as to impose an arduous requirement. The provision of information as at 30 June should be information provided as part of the external examination process and as such is an annual exercise. We do not consider that the Taskforce should look to dilute the provision of information unless it can be demonstrated that the reporting is being unnecessarily duplicated. The language being used is emotive when discussing "compliance burdens". It could be argued that all compliance is a burden but that is not sufficient grounds to dispense with compliance totally. The burden needs to be measured against the obligations to protect client money. At the last bullet point on page 6 we wonder under what circumstances it is contemplated that notice would have to be given when required by the regulator of the receipt or holding of trust money. Is this to cover by another means suspicious transactions or large cash transactions? Depending on in what instances notice is to be required, this could potentially be burdensome if broadly defined.

### ***External examinations of trust account records***

It is agreed that this is an important mechanism of regulation. However Rules should be written to identify and limit exemptions from compliance. As a principle every trust account should be audited annually the only exception should be where a trust account has had no transactions during the audit period and in such circumstances the principal should be required to lodge a statutory declaration to that effect. This should be the only permitted exemption from the requirement for an annual examination. Again we would be concerned if the external examination requirements were simplified to such an extent that they become worthless. Rules should be made about the examination period and date for lodgement of the examiners report so that these are nationally consistent.

### ***Regulator initiated examinations, investigations and interventions***

On page 7 the paper makes the point that random investigations of trust accounts have not generally identified major defalcations of trust accounts. It has to be conceded that this is true. Whether external examinations have more success is doubtful as the purpose of the examination is more about testing compliance with the legislative requirements for operating a trust account than forming a true and fair view of the practice trust accounts. The retention of external examiners to continue this compliance examination is supported.

The Trust Account Investigators could then be deployed to conduct a more detailed and intensive examination of a practice's trust account and other records in a targeted way. They would then become investigators in nature as well as name, and the incidence of detection of irregularities resulting in defalcations should increase. Any increased costs of resourcing would remain to be shared in accordance with whatever funding structure is eventually agreed on for the new scheme, rather than requiring a much more intensive audit the costs of which would fall to the individual practices.

In addition it is strongly suggested that the new Regulations explicitly permit an investigator to contact the practitioner's client where necessary to verify transactions or seek further information. The present legislation does is silent on this and the current opinion is that it is not currently regarded as permitted. We

believe that the provision of a Trust Account Statement or proper accounting should be able to be independently verified.

### ***Jurisdictional linkages and single national trust accounts***

Noting this topic is to be the subject of a separate detailed paper we make the following comments as part of the general discussion.

Whilst this may assist some law practices which practice in multiple jurisdictions the Task Force should not lose sight of the fact that interest paid on trust money is relied upon by the various jurisdictions to provide funding for a number of purposes. Single trust accounts mean that some jurisdictions (usually the smaller) would lose interest to the other where the trust account is maintained. To fairly compensate the affected jurisdictions the law practice would need to closely monitor the amount of trust money derived from the various jurisdictions (an additional cost in itself) to enable the various jurisdictions to obtain the interest to which it would have otherwise been entitled. Moreover somebody will need to bear the cost of making the interest calculations and paying the interest to the appropriate jurisdictions. This cannot be a function of an ADI.

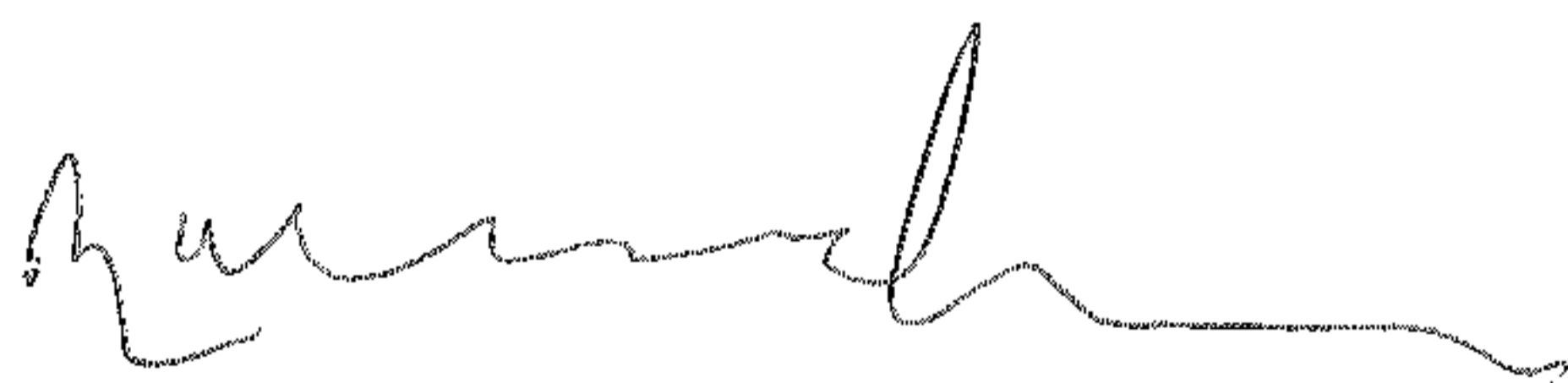
Where a firm has offices in more than one jurisdiction should it be required to operate just a single trust account for the entire practice, or a separate account in each place? It is assumed that the opportunity to operate a single trust account would be at the option of rather than a requirement of a law practice.

Some of the issues come down to the place of investigation and external examination. There must continue to be full and easy access to all the trust accounting records of the practice, to ensure full compliance with the trust accounting regulations and to allow for proper investigation and examination. There needs to be safeguards put into place to prevent an office from using the excuse "those records are in our interstate office" in order to cover any wrong-doing.

It is submitted that if a firm elects to operate a single trust account then the practice be required to declare a "home" jurisdiction or head office, at which all records are centralised.

We note in conclusion that the Discussion Paper does not deal with the issue of exclusion of mortgage financing or managed investments. These are matters which should be included in the Regulations covering trust accounts.

Yours sincerely



Richard Mellows  
**PRESIDENT**