NSW Law Reform Commission

REPORT 44 (1984) - FOURTH REPORT ON THE LEGAL PROFESSION: SOLICITORS' TRUST ACCOUNTS

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Terms of Reference and Participants

New South Wales Law Reform Commission

To the Honourable Mr. T.W. Sheahan, B.A., LLB., M.P. Attorney - General for New South Wales.

FOURTH REPORT ON THE LEGAL PROFESSION

(SOLICITORS' TRUST ACCOUNTS)

We make this Report under our reference to inquire into and review the law and practice relating to the legal profession.

Professor Ronald Sackville

(Chairman)

Julian Disney

(Commissioner)

21 December, 1984.

New South Wales Law Reform Commission

The New South Wales Law Reform Commission is constituted by the Law Reform Commission Act 1967. The Commissioners are:

Chairman

Professor Ronald Sackville

Deputy Chairman

Mr. Russell Scott

Full-time Commissioners

Paul Byrne

Miss Deirdre O'Connor

Professor Colin Phegan

Part - time Commissioners

Mr. Julian Disney

Her Hon Judge Jane Mathews

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The Hon. Justice Peter Nygh

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This is the forty - fourth Report of the Commission. Its short citation is LRC.44.

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Preface

The Commission has received a reference from the then Attorney General and Minister for Justice, the Honourable F.J. Walker, Q.C., M.P., to inquire into and review the law and practice relating to the legal profession. The terms of reference are set out in full in appendix 1 of this Report.

This is the fourth Report published in the course of our Legal Profession Inquiry. It deals with a wide range of issues relating to solicitor's trust accounts, and it contains our final recommendations on these issues.

Earlier in the Inquiry we published a Discussion Paper containing our tentative suggestions on these matters. That Paper and other Papers issued in the course of the Inquiry are listed on page vii below.

The Discussion Paper and this Report have been prepared by a Division of the Commission By virtue of the Law Reform Commission Act, a Division is deemed, for the purposes of the reference in respect of which it is constituted, to be the Commission.

At the time of publication of the Discussion Paper, the Division consisted of the following Commissioners:

Mr. R.D. Conacher (Deputy Chairman)

Mr. Julian Disney

Mr. Denis Gressier

His Honour Judge Trevor Martin Q.C.

The Chairman of the Commission, Professor Ronald Sackville, presided over meetings of the Division but was not. a member of it. The previous Chairman of the Commission Mr. Justice J.H. Woottem was closely involved in earlier stages of the Legal Profession Inquiry although he was no longer on the Commission when the Discussion Paper was published.

Mr. Conacher and Judge Martin ceased to be members of the Commission prior to the commencement of work on this Report - Mr. Gressier was closely involved in the early stages of its preparation but retired from the Commission in December 1983 upon his appointment as Master in Equity of the Supreme Court of New South Wales. Mr. Disney then took over principal responsibility for the preparation of the Report with the assistance of Professor Sackville.

The Commission wishes to acknowledge the considerable assistance which has been provided to it in the course of preparing this Report In particular, the Law Society of New South Wales has provided extensive information and comment at our request and we have also had the benefit of comment from two honorary consultants, namely Mr. John Dorter (solicitor) and Mr. Jack O'Donnell (Auditor General for New South Wales). Officers of law societies throughout Australia, and in New Zealand, England and Canada have responded helpfully to our requests for information. Assistance provided at earlier stages of our work on solicitor's trust accounts is acknowledged in Chapter 1 of this Report.

A large number of persons and organisations made submissions to us on matters relevant to the Legal Profession Inquiry, including solicitor's trust accounts. They are listed in Appendix II of our *First Report on the Legal Profession.* In addition, a number of articles, papers and editorials have commented on tentative suggestions which we made in Discussion Papers. Some of these articles and papers are listed in Appendix III of the *First Report.* We list m Appendix IV of that Report some of the many persons and organisations, both in Australia and overseas, that have responded to our requests for information or advice. We are most grateful to all those who have assisted us in these ways.

The Commission expresses its appreciation of the important contribution made by Its research, administrative, secretarial and library staff. Extensive research assistance in the preparation of this Report was provided by Michael Hogan. At an earlier stage preliminary research was undertaken by Julia Hall. Secretarial assistance was provided principally by Lorna Clarke, Margaret Edenborough and Kerry Gill.

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Legal Profession Inquiry Publications

The following publications have been issued up to the present time in the course of the Legal Profession Inquiry.

Reports

First Report on the Legal Profession.

(General Regulation The Division into Barristers and Solicitors, Queen's Counsel, and Court Dress)

Second Report on the Legal Profession.

(Complaints, Discipline, and Professional Standards)

Third Report on the Legal Profession.

(Advertising and Specialisation)

Fourth Report on the Legal Profession.

(Solicitors’ Trust Accounts)

Discussion Papers

1. General Regulation.

2. Complaints, Discipline and Professional Standards - Part 1.

3. Professional Indemnity Insurance.

4. (1) Structure of the Profession - Part 1.

   (2) Structure of the Profession - Part 2.

5. Advertising and Specialisation.

6. Solicitors’ Trust Accounts and the Solicitors’ Fidelity Fund.

Background Papers

1. Background Paper-I.

(Complaints, Discipline and Professional Standards)

2. Background Paper-II.

(Professional Indemnity Insurance)

3. Background Paper-III.

(Complaints, Discipline and Professional Standards)

4. Background Paper-IV.

(Structure of the Profession)

5. Background Paper-V.

(Solicitors’ Trust Accounts and the Solicitors' Fidelity Fund)

Options Paper

Solicitors' Costs and Conveyancing.

Summary of Recommendations

I. INTRODUCTION

The following is a summary of the principal recommendations made by the Commission in this Report. We indicate the paragraph numbers of the Report which deal with the respective topics.

II. HANDLING TRUST MONEY: GENERAL

(Chapter 4)

A Paying Money into Trust Accounts (paras 4.3-4.50)

1. Money which Must be Paid into a Trust Account (paras 4.4-4.20)

The Capacity in which Money is Received (paras 4.5-4.11)

R.1: Solicitors should be required to pay into their trust accounts any money entrusted to them "in the course of acting as a solicitor or of acting, in connection with their practice as a solicitor, in the capacity of trustee, agent, bailee, stakeholder, mortgage broker, company director or any other capacity. This would require an amendment to section 41(1) of the Legal Practitioners Act, 1898. It would also be desirable for the Law Society to develop guidelines f or the interpretation of this provision in particular contexts.

Money Received Outside New South Wales (paras 4.12-4.17)

R.2: (1) The requirement for solicitors to pay money into a trust account in a bank should apply to any money received by a solicitor in the course of practising as a New South Wales solicitor, regardless of whether the money was received in New South Wales or elsewhere.

(2) Where the money is received outside New South Wales and never brought into this State, the requirement that the money be paid into a bank in New South Wales should not apply, but in all other respects the trust account requirements of this State should apply.

R.3: (1) The Law Society of New South Wales should seek the co-operation of other law societies in developing specific guidelines for the handling of trust moneys received by solicitors who practise In more than one State and in making agreements as to which jurisdictions rules are to be applied to a particular firm or a particular transaction.

(2) In order to give effect to such guidelines and agreements, the Law Society should be given power to direct that certain money which falls within the ambit of New South Wales trust account legislation should be dealt with in accordance with the legislation of another State.

Prompt Deposit (paras 4.18-4.20)

R.4: Where money is required to be deposited in a solicitor's trust account it should have to be deposited without delay and in any event not later than the end of the next banking day after the day on which it is received by the solicitor.

2. Money which May, but *Need Not,* be Paid into a Trust Account (paras 4.21-4.39)

Instructions to Dispose (paras 4.35, 4.38)

R.5: (1) Solicitors should not be required to pay trust money into a trust account where, not later than the end of the next banking day after its receipt the money is to be disposed of by the solicitor

in accordance with written instructions by the person for or on whose behalf it was received; or

in the same form in which it was received and in accordance with instructions, whether written or oral, by the person for or on whose behalf it was received.

Where there are express written instructions that the money is not to be paid into a trust account, the solicitor should not be permitted to pay it into such an account.

(2) By "payment in the form in which it was received" we mean that

in the case of payment in cash, the amount of cash paid must be the same as the amount of cash received;

in the case of payment by cheque or draft - payment must be effected by endorsement of the cheque or draft received.

Direct Payments Register (paras 4.36, 4.39)

R.6: Where trust money is not paid into a trust account details of the manner in which it has been dealt with should have to be recorded by the solicitor in a prescribed form of Direct Payments Register. The Register should constitute part of the solicitor's trust account records and be subject to independent scrutiny in the same manner as those records. Appropriate details should also be recorded in the trust receipt book and ledger.

R.7: The Direct Payments Register should be required to indicate

(i) the amount of money received;

(ii) when the money was received;

(iii) the name and address of the person for or on whose behalf the money was received;

(iv) whether the money was in cash, cheque or other form;

(v) where the money was in cheque form, the cheque number and the bank on which the cheque was drawn;

(vi) the name of the person from whom the money was received;

(vii) the manner in which it was received (for example, in person or by post);

(viii) the nature, and date of receipt of any direction for payment made by the person for or on whose behalf the money was received;

(ix) the amount of money which was paid;

(x) the name and address of the person to whom the money was paid;

(xi) the date on which the payment was made;

(xii) the form in which it was made (for example, cash, endorsed cheque, cheque); and

(xiii) the manner in which the payment was delivered (for example, in person or by post).

3. Money which *Must Not* be paid into a Trust Account (paras. 4.40-4.50)

R.8: Specific legislation should be enacted to the effect that money must not be paid into a solicitor's trust account unless it is

trust money;

money which is partly trust money and partly the solicitor's own money, provided that the latter is then withdrawn from the trust account within one month;

money which the solicitor considers on reasonable grounds is, or may be, trust money;

money incorrectly withdrawn from the account; or

money necessary to open or maintain the account.

B. Withdrawing Money From Trust Accounts (paras 4.51-4.73)

Written Instructions (paras 4.52-4.61)

R.9: Generally speaking, solicitors should not be required to obtain written authorisation in advance before withdrawing money from trust accounts. We make a specific recommendation, however, in relation to withdrawals for the purposes of investment (see R.57 below).

Forms of Payment (paras 4.62-4.66)

R. 10: All payments from trust accounts should have to be made by crossed cheques which are marked "not negotiable" and payable to order.

III. HANDLING TRUST MONEY: ISSUES RELATING TO COSTS AND DISBURSEMENTS

(Chapter 5)

A Payment into a Trust Account (paras 5.2-5.4, 5.15-5.24, 5.46-5.48)

R.11: Money received by a solicitor for or on account of costs or disbursements should have to be paid into a trust account unless

the client has given written instructions for the money to be handled in some other way, and before or upon receipt of the money the solicitor delivers to the client an outline bill or receipt identifying the services or disbursements for which the money is being paid; or

work has been done or disbursements have been made, an outline bill has been delivered to the client, and the money is applied towards payment of that bill.

If either of these two exceptions applies,

the money must not be paid into a trust account unless in the case of the first exception the client's instructions leave the solicitor with a discretion as to whether or not the money is to be so paid pending its payment elsewhere; and

the transaction must be recorded in the Direct Payments Register (see R6 above).

R.12: If work has not been done, or disbursements have not been made, at the time of receipt of the money, but it is done or they are made, and a bill is delivered, before the next banking day, the money must not be paid into a trust account (if such payment into the trust account has not already occurred before the bill is delivered).

R.13: In order to constitute an "outline bill", a bill should contain sufficient particulars to enable the general nature and scope of the work and/or disbursements to be identified and to be distinguished from other work done or likely to be done, or disbursements made or likely to be made, for the client in question. The bill should indicate the period which it covers.

B. Withdrawal from a Trust Account (paras 5.5-5.11, 5.25-5.39, 5.49-5.52)

R.14: A solicitor should not be permitted to withdraw money from a trust account for or on account of his or her own costs or disbursements unless

the solicitor has delivered to the client an outline bill and the client has thereafter given written instructions, in a prescribed form, for the withdrawal to be made;

the solicitor has delivered to the client an outline bill, attached to which is a statement in a prescribed form that money to meet the bill will be withdrawn from the trust account unless the client objects within one month to the quantum of the bill, and no such objection has been made;

the solicitor has made disbursements on the instructions of the client; or

the withdrawal is made to satisfy a judgement debt owed by the client to the solicitor.

R.15: The prescribed form for written instructions should include a statement explaining to the client that he or she is under no obligation to sign the form, and outlining the rights which he or she has if the form is signed, or is not signed, respectively.

R.16: (1) If a client objects to the outline bill within one month, the solicitor should then have to prepare and deliver a bill in taxable form.

(2) If the client does not seek taxation within one month after receiving the taxable bill, the solicitor should be entitled to withdraw sufficient money to meet the bill.

R.17: Where a solicitor has become entitled to withdraw money in accordance with the above rules, he or she should be required to make the withdrawal within one month of becoming so entitled, save where the entitlement relates either to disbursements or to work which has not yet been completed.

C. Refusal to Withdraw from a Trust Account (paras 5.12-5.14, 5.40-5.45, 5.53)

R.18: (1) The particular lien presently enjoyed by solicitors in relation to certain money received by them should be abolished.

(2) The uncertainty about whether or not solicitors in New South Wales have a general lien over trust money should be resolved by legislation. We do not necessarily oppose the existence of such a lien (at least in relation to trust money), provided that in addition to, or in substitution for, the existing system for taxation of costs a new system for reviewing bills of costs is established which is fair to both solicitors and clients but is simpler, quicker and cheaper than the existing taxation process.

IV. RECORDING AND ACCOUNTING FOR TRUST MONEY

(Chapter 6)

A. Opening Files and Retaining Records (paras 6.3-6.11)

R.19: Solicitors should be required to open a file for every matter which involves the handling of trust money, and to record in that file such information as, in conjunction with the trust account records, will explain all trust money transactions involved in the matter in question.

R.20: Solicitors should be required to retain

> all trust ledger accounts, cash books and journals for at least 12 years, and all other trust account records for at least seven years, after the last entry appearing in them;
>
> all Direct Payments Registers (and Securities and Investments Registers, see R-58 below), for at least 12 years; and
>
> all files relating to trust money transactions for at least 12 years after the date of the last transaction.

B. Computerised Trust Accounts (paras 6.12-6.24)

R.21: (1) The Solicitors Trust Account Regulations should be amended to give the Law Society of New South Wales power to approve trust accounts recording systems.

(2) Other amendments to the basic " book-keeping" aspects of those regulations should be made along the general lines of regulations 3-9 and 11 of the Law Society's draft reproduced in Appendix III of this Report.

R.22: (1) Within the next three years, the Regulations should be further amended to provide more specific and comprehensive rules relating to the keeping of trust account records, including those which are in computerised form, and to reduce substantially the need for the Law Society to be involved in an extensive "approval" or "exemption" role.

(2) Accordingly, the Attorney - General should establish a special committee to monitor the operation of the interim amendments which we have recommended above (R.21) and to develop proposed new regulations (and such non-statutory rules, guidelines or other material as it may consider necessary) for submission to the Government in not more than three years time.

(3) An appropriate composition for this special committee would be the Auditor General (as chairperson), two representatives of the Law Society, one representative each of the Institute of Chartered Accountants and the Australian Society of Accountants, one or two experts in computers, and the Parliamentary Counsel or his or her nominee.

C. Statements of Account to Clients (paras 6.25-6.32)

R.23: (1) Where solicitors receive trust money for a client they should be required to provide the client with a statement of account in relation to that money

where the matter is not completed within six months - not more than six months after its commencement and at intervals of not more than three months thereafter;

within one month of completion of the matter in question; and

at any other time upon request by the client.

(2) This duty should not be capable of being waived by the client.

R.24: (1) The statements of account should be required to provide particulars of all receipts and payments of trust money, and the total amount of any such money remaining.

(2) Each statement should be deemed part of the solicitor's trust account records and accordingly be subject to independent scrutiny (see below).

D. Trial Balances and Bank Reconciliations (para 6.34)

R.25: Solicitors should be required to prepare trial balances and bank reconciliations of their trust accounts as at the end of each month, and to do so within 21 days of that date.

V. INDEPENDENT SCRUTINY: LAW SOCIETY INSPECTIONS AND INVESTIGATIONS

(Chapters 7 and 8)

A Frequency of Inspection (paras 7.5-7.9, 8.3, 8.16, 8.23)

R.26: (1) The Law Society should ensure that it achieves within the next year its recently stated objective of inspecting the trust accounts of every practice in the State once each year, and should maintain that frequency of inspection thereafter. The Society should ensure that this increased frequency is accompanied by further refinement of inspection techniques.

(2) At least during the next few years, the Law Society should inspect sole practices more frequently than other practices and/or ensure that inspections of sole practices are particularly thorough.

B. Powers of Inspectors (paras 7.2-7.4, 8.13, 8.16-8.19, 8.24)

R.27: The Law Society’s Inspectors should have the same extensive powers as Investigators now have to require solicitors to provide documents (such as office files and general accounts) and other information which relates to the solicitor’s practice.

R.28: Inspectors should have access to any check - list, audit program, working papers and other documents used by the accountant responsible for examining a particular practice's trust accounts (see below) and should be expressly entitled to confer with the accountant.

VI. INDEPENDENT SCRUTINY: ACCOUNTANTS' EXAMINATIONS

(Chapters 7 and 9)

A. Trust Accounts to be Audited Annually (paras 9.37-9.38, 9.48, 9.67, 9.71)

R.29: Solicitors' trust accounts should have to be audited each year. Without limiting the generality of that requirement - a number of other requirements of a general nature should be specified by statute (see RR.30-35 below).

B. General Requirements of the Audit (paras 9.10-9.77)

R.30: The principal purpose of the audit should be defined as the detection of frauds, defalcations, illegalities and irregularities. This would not mean however, that accountants conducting the audit would have to give an opinion that no fraud etc. has taken place, nor that an accountant who acted with all reasonable care and skill would nevertheless be liable for failing to detect for example, a well-concealed defalcation.

R.31: The audit should have to be conducted in accordance with the current Statements of Auditing Standards and Auditing Practice published by the Institute of Chartered Accountants in Australia and the Australian Society of Accountants.

R.32: Accountants conducting these audits should be required to state in their report whether, based on appropriate examination and sampling techniques, they are of the opinion that throughout the period covered by the report

> trust moneys have been handled in accordance with the relevant statutory provisions (ie. at present section 41 of the Legal Practitioners Act); and
>
> the proper accounting records have been kept, and all trust moneys have been recorded and accounted for in accordance with the relevant statutory provisions (ie. at present sections 41 and 42(2) of the Legal Practitioners Act and the Solicitors' Trust Account Regulations).

This would mean, amongst other things, that an opinion would have to be given about whether, as required by section 42(2), the records have been kept "in such a manner as to disclose the true position in regard I to the trust moneys and to enable the account to be conveniently and properly audited".

R.33: Accountants conducting such audits should also be required to report

whether, in their opinion, the practice's accounting and financial control systems are adequate for a practice of its particular nature; and

any other matter which they consider should be brought to the attention of the Law Society.

R.34: (1) Accountants responsible for auditing a practice should be required to make at least one unannounced visit (or, in the case of sole practices, at least two such visits) to inspect the practice's accounts during the period covered by the annual audit, with the principal purpose being to form an opinion whether, based on limited sampling riot amounting to an audit, the accounting records are being kept in the required form and are reasonably tip to date, there are no debit balances in the trust ledger, and the prescribed trial balance statements have been properly prepared.

(2) This opinion should be stated subsequently in the annual audit report but if the accountant detects any material irregularity or breach of the law it should have to be reported forthwith to the Law Society.

R.35: (1) For the purposes of conducting an audit accountants should have access not only to the trust account records but also to office files, general accounts and all other documents relating to the practice, and should be entitled to require the solicitor to provide such other Information as is reasonably necessary, for the purposes of the audit.

(2) If an accountant seeks access to such material or information and is refused, he or she should have to mention the refusal in the audit report.

(3) Information covered by legal professional privilege should retain that protection despite disclosure to the accountants except where it is to be given in private session in the course of disciplinary proceedings against the solicitor.

VII. INDEPENDENT SCRUTINY: OTHER ISSUES

(Chapter 10)

A Specific Aspects of Examinations and Inspections (paras 10.2-10.32)

Client Verification (paras 10.2-10.20)

R.36: (1) Accountants' examinations should be required to include client verification of a sample of the solicitor's trust account records. The sampling basis should be determined by the individual accountant and explained in his or her report.

(2) If it is considered, contrary to this recommendation, that client verification should not be required in every case, we consider nevertheless that accountants should be expressly entitled to seek client verification and should be required to include in their report the nature of any client verification which they have carried out or the reasons why such verification was considered unnecessary.

R.37: (1) When seeking client verification accountants should be required to send a letter in prescribed form to the client.

(2) The letter should be accompanied by details, in a readily comprehensible form, of the trust account records which it is sought to verify and should ask the client to respond directly to the accountant.

(3) The prescribed form of letter should explain that requests for verification are required in relation to every solicitor, that clients to be contacted are chosen on a random basis (if that is the case), and that a request for verification should not be regarded as a ground for suspicion.

(4) Clients should be provided with details of all trust account entries relating to them for a recent period, rather than merely the balance currently shown in their accounts.

R.38: In addition the Law Society's Inspectors should be expressly empowered to seek client verification in the course of routine inspections, if they consider it appropriate to do so, provided that they use a prescribed form of letter similar to that which we have recommended above in relation to accountants.

Other Specific Checks (paras 10.21-10.32)

R.39: (1) In addition to certain basic book-keeping and arithmetical checks, accountants' examinations should be required to include checks of systems, and sample checks, in order to enable the accountant to express an opinion whether

transactions in respect of

(i) the solicitor's costs and disbursements; or

(ii) the administration of estates;

have been handled and recorded correctly;

the Direct Payments Register has been maintained correctly;

the requirements concerning delivery of statements of account have been satisfied;

reconciliations between the trust ledger and the bank records have been prepared each month; and

conveyancing or borrowing transactions between the solicitor and his or her clients have been made in compliance with the rules and Law Society statements relating to the provision of independent legal advice for clients (see paras 11.5 - 11.6 of the Report) and any trust moneys involved have been handled and recorded correctly.

(2) In order to facilitate the last of these checks, solicitors should be required to disclose to their accountant all conveyancing or borrowing transactions between themselves (or an associated party) and one or more of their clients.

(3) Accountants should be required to state in their reports that they have undertaken each of these checks, and to state their opinion on each of the matters listed above.

R.40: (1) The Law Society, in conjunction with the two principal associations of accountants and the Auditor General, should prepare an advisory audit Program (or different Programs for different types of practice) and issue it to all accountants responsible for examining solicitor's trust accounts.

(2) The Program should include, amongst other things, items of the kind that are currently included in the check-list for Inspectors, especially those to which we refer in paragraph 10.22 of the Report.

(3) The Program should be supplemented by regular Audit Circulars.

(4) Accountants should be required to state in their reports that they have perused the current Program and Circulars.

R.41: It should be made clear to accountants that the generality of their obligations to conduct an audit and to express opinions of a general nature about compliance with the law are not limited to carrying out such specific checks as are required by statute or mentioned in an Audit Program.

R.42: Consideration should be given to amending the check - list for Inspectors so as to require them to conduct some or all of the checks which we have recommended above should have to be conducted in the course of accountants' examinations.

B. Appointment, Qualifications and Other Issues Relating to Accountants (paras 10.33-10.66)

Appointment and Removal (paras 10.34-10.44)

R.43: Appointment of the accountant by whom a solicitor's trust accounts are to be examined should be made by the solicitor, and notified to the Law. Society, within one month of the solicitor first holding any trust money.

R.44: Appointments should be subject to the Law Society's approval and the Law Society should be entitled to withhold or withdraw approval if it believes on reasonable grounds that the accountant in question may not properly perform his or her duties or has not properly performed them in the past.

R.45: The Law Society should not withhold or withdraw approval without giving the accountant and the solicitor an opportunity to show cause why approval should be granted, and there should be a right of appeal to the Supreme Court against a withholding or withdrawal.

R.46: Solicitors should not be permitted to terminate an accountant's appointment without the approval of the Law Society, which approval should not be unreasonably withheld.

R.47: Accountants should not be permitted to resign an appointment without the approval of the Law Society, which approval should not be unreasonably withheld.

R.48: Persons seeking approval for termination or resignation should be required to provide reasons therefore to the Law Society.

Qualifications and Training (paras 10.45-10.54)

R.49: Accountants' examinations should have to be conducted by accountants who are registered under the Public Accountants Registration Act, 1945.

R.50: (1) The Law Society, in conjunction with the principal associations of accountants, should organise at least once each year a seminar relating to examination of solicitor's trust accounts.

(2) Accountants who are responsible for examining such accounts should be required to attend at least one of these seminars every two years.

Other Work for the Solicitor (paras 10.55-10.60)

R.51: (1) Save with the approval of the Law Society, accountants who have been appointed to examine a solicitor's trust accounts should not be permitted to carry out any other work for that solicitor except

the auditing of other accounts maintained by the solicitor in the course of his or her practice; or

advisory or consulting duties consequential on his or her function as the examining accountant or auditor of other accounts of the practice.

(2) Accountants should be prohibited from acting as the examining accountant for any solicitor of whom they have been an employee at any time within the two years prior to the period covered by the examination.

(3) Examining accountants should be required to state in their reports that they have not contravened these prohibitions.

Delivery of Reports (paras 10.62-10.66)

R.52: Accountants should be required to submit their report directly to the Law Society, and the Society should then be responsible for forwarding a copy of the report to the solicitor unless it considers that the report should be withheld in the interests of preventing, detecting, or preserving evidence of, irregularities. The accountant should not be entitled to disclose his or her report to the solicitor without the approval of the Law Society.

C. Duties to Disclose Reasonable Suspicions (paras 10.67-10.79)

R.53: Solicitors, and accountants conducting examinations of solicitor's trust accounts, should be under a general statutory duty to report promptly to the Law Society any facts or circumstances which have given rise in their minds to reasonable suspicions that

a solicitor has failed properly to pay or account for trust moneys, or is likely to do so in the immediate future;

a solicitor has committed a material breach of the statutory provisions relating to the handling and recording of trust moneys;

a solicitor's trust account is overdrawn or has debit trust ledger balances for which no satisfactory explanation has been provided; or

cheques drawn on a solicitor's trust account have been dishonoured due to an insufficiency of funds in the account.

R.54: (1) Banks should be under a general statutory duty to report promptly to the Law Society

whenever a solicitor's trust account is overdrawn; or

whenever a cheque drawn on such an account is dishonoured.

(2) In order to assist bankers to comply with this duty, all trust bank accounts held by a solicitor should have to include the words "Solicitors Trust Account" in their title.

R.55: Any such report made by solicitors, accountants or banks should remain confidential to the Law Society save to the extent that it is necessary to disclose it in the course of disciplinary or court proceedings or in order to comply with duties of disclosure to the police.

VIII. INVESTMENT OF CLIENTS' MONEY

(Chapter 11)

A Borrowing from Clients (paras 11.4-11.11)

R.56: (1) The substance of the Law Society's ruling in 1979 about borrowing from clients (see paras 11.5-11.6 of the Report) should be embodied in statutory regulations.

(2) Also, the definition of the solicitor's immediate family should be extended to include spouses of the relatives currently listed, and spouses should be defined as including de facto spouses.

B. Instructions from Clients (paras 11.12-11.17)

R.57: Solicitors should be subject to a general requirement to obtain the clients written authorisation in a prescribed form before using trust money for the purposes of investment It may be appropriate, however, to make certain limited exceptions to this requirement.

C. Registers and Summaries of Investments (paras 11.18-11.26)

R.58: (1) Solicitors should be required to maintain a Securities and Investments Register containing prescribed details of

all mortgages and other securities which are held in their name on trust or under which they are authorised to collect principal and/or interest; and

all investments of trust monies for or on behalf of any person and for which there is no such mortgage or security.

(2) We have expressed the above recommendation in general terms, but there may be a case for certain limited exceptions. For example, the Law Society has proposed an exception for securities handed to a solicitor in a scaled packet for safe custody only. In relation to the details which ought to be prescribed, we agree with the substance of the proposals made by the Law Society (see Appendix III of this Report reg.15).

R.59: Entries in the Securities and Investments Register should have to be made within a prescribed time. The Register should form part of the trust account records and therefore, amongst other things, be subject to the same independent scrutiny as other parts of those records.

R.60: Solicitors should be required to provide lenders, within a prescribed time, with a Summary containing the same details of transactions made on their behalf as are included in the Securities and Investments Register.

D. Nominee Companies (paras 11.27-11.36)

R.61: Solicitors should be entitled to operate nominee companies subject to the following conditions.

(i) All members and directors of the company should have to be solicitors (subject to an exception in the case of sole practitioners, along the lines currently proposed by the Law Society - see para.1 1.34 of the Report).

(ii) The company’s activities should have to be confined to holding or dealing with property on trust

(iii) The company and its directors should be prohibited from deriving any financial benefit from its activities, other than solicitor’s professional costs for acting as a solicitor.

(iv) The directors should be required to guarantee Jointly and severally the repayment of principal, and the payment of due interest, to lenders.

(v) The company should be required to execute appropriate declarations of trust, or otherwise to evidence the trust, in respect of each transaction.

(vi) Money received by the company should be subject to the-statutory provisions relating to solicitor’s trust money in the same way as if it is received by the solicitor as trust money (Including, for - example, the provisions relating to the keeping of Registers and the provision of Summaries to lenders).

(vii) The company's accounts should be ' deemed part of the solicitor’s trust accounts, and be subject to the statutory provisions relating to such accounts (Including, for example, the provisions relating to inspections and accountants' examinations).

(viii) For the purposes of the rules of professional conduct, the acts of the company should be deemed to be also the acts of each of its directors, and the acts of solicitors as directors should be deemed to be acts in the course of their practice as solicitors.

E. Private Finance Companies (paras 11.37-11.62)

R.62: (1) Solicitors' private finance companies should be prohibited. Solicitors currently having an interest in such companies should be given a reasonable time (say, two years) within which to withdraw from them or wind them up.

(2) If, however, it is considered that such companies should not be prohibited, they should be required to be licensed by the Corporate Affairs Commission in accordance with a scheme of the kind currently administered by the Commissioner or Corporate Affairs in Victoria, and the Law Society should be entitled to examine the accounts and other records of such companies.

1. The Legal Profession Inquiry and this Report

I. INTRODUCTION

1.1 The Commission has a reference from the then Attorney General of New South Wales, the Hon F.J. Walker, Q.C., M.P., to inquire into a wide range of matters in relation to the legal profession in New South Wales. The terms of reference for this Legal Profession Inquiry, as it has become known, are reproduced in Appendix 1 of this Report.

1.2 In the course of the Inquiry we have published three Reports, each of which contains our final recommendations to the Attorney General on particular topics. - The *First Report* deals with general regulation of the legal profession the division of the profession into barristers and solicitors, various aspects of the Queen's Counsel system, and the dress worn by advocates in court. The *Second Report is* concerned with the making, investigation and adjudication of complaints about lawyers, and certain other matters concerning discipline and standards within the legal profession. The *Third Report* considers restrictions on advertising and other forms of attraction of business by lawyers, and regulation of specialisation within the profession.

1.3 Each of these Reports was published in 1982 and is currently under consideration by the Government. Relevant developments since their publication have been summarised in our Annual Reports for 1982, 1983 and 1984 respectively. The 1982 Annual Report also contains a survey of the wide-ranging changes in the legal profession which have occurred since we published our first Discussion Paper in 1979.

II. THE SCOPE OF THIS REPORT

1.4 The present Report is concerned with the law and practice relating to solicitors trust accounts. The following parts of our terms of reference are of particular relevance to these topics:

> "To enquire into and review the law and practice relating to the legal profession and to consider whether, and, if so, what changes are desirable in
>
> (a) the structure, organisation and regulation of that profession;
>
> (b) the functions, rights, privileges and obligations of all practitioners; and
>
> (c) the provisions of the Legal Practitioners Act - 1898 and the Rules and Regulations made thereunder and other relevant legislation and instruments,

with particular reference to but not confined to the following matters -

...

(h) the fixing and maintenance of ethical standards;

(i) the making, investigation and adjudication of complaints concerning the professional competence or conduct of legal practitioners and the effectiveness of the investigation and adjudication of such complaints by professional organisations;

(j) the making, investigation and adjudication of complaints concerning charges made for work done by legal practitioners;

(r) fidelity guarantees ... ;

(s) the Statutory Interest Account;

(t) the supervision by independent third parties of trust accounts of legal practitioners;

(u) the necessity for participation by legal practitioners in courses of continuing legal education.

III. OUR METHODS OF INQUIRY

A. General

1.5 At the commencement of the Legal Profession Inquiry we issued a general invitation to lawyers and members of the public to make submissions to us. We have received more than 400 submissions from a wide range of people and organisations, including some from other parts of Australia and from overseas. A number of responses have been made in other forms such as articles in periodicals, speeches and press releases.[1]

1.6 We have had discussions with a wide range of lawyers about issues relevant to the Inquiry. Some of these meetings were at our initiative, while others were in response to invitations. They included State and regional law society meetings, barristers' meetings, national and international conferences of lawyers, and university seminars, as well as many private interviews.[2] We arranged meetings on numerous occasions with office - bearers of the Law Society of New South Wales and the New South Wales Bar Association in order to discuss particular aspects of the Inquiry.

1.7 We have also had discussions with a large number of non - lawyers, including members of other professional disciplines such as accountancy. A special effort was made to obtain the views and experiences of people who are unlikely to write submissions to Inquiries or speak at public meetings, but who nevertheless may have well-informed and responsible views to express. We conducted "open houses" in eight country and six suburban centres where, at well - publicised times, any member of the public could talk privately to a member of the Commission (or, less frequently, to a member of the Commission's staff about his or her experiences with lawyers. More than 300 people attended these

open houses. More than 500 other people telephoned, visited, or wrote to us at the Commission. In addition we examined over 600 files in which the Law Society of New South Wales or the New South Wales Bar Association had dealt with complaints against their members, and we obtained information about many hundreds of other complaints.[3]

1.8 We have carried out a considerable amount of empirical research. Much of this research has been the subject of reports published in our Background Papers.[4] In addition we co-operated with the Law Foundation of New South Wales in an extensive questionnaire survey of the profession.[5] We also have undertaken or commissioned bibliographical research into the history and present operation of the legal profession and of certain other professions, in New South Wales and many other parts of the world. We have been assisted in this work by a number of academic consultants from law and other disciplines.[6]

1.9 With the benefit of the information and ideas obtained by the means referred to above, we prepared and published a series of six Discussion Papers on various topics falling within our terms of reference.[7] These Papers described the present position in New South Wales in relation to the topics under consideration and made tentative suggestions for change in a number of areas. They were supplemented by five Background Papers containing further information about the position in New South Wales and in some other places.[8]

1.10 The Discussion Papers were published in order to obtain the benefit of responses to tentative suggestions before we decided upon final recommendations to be made in our Reports. The Papers received considerable publicity in the media, resulting in further submissions and other responses to us. They were also the subject of seminars and sessions of lawyers' conferences in New South Wales and elsewhere.

B. Solicitors' Trust Accounts

1.11 Matters relevant to solicitor's trust accounts were canvassed in many of the submissions, discussions and research reports to which we have referred above. Particular mention should be made here of two lengthy submissions by the Law Society of New South Wales, and of discussions with representatives of that society, the New South Wales Auditor-General (Mr. Jack O'Donnell), the Joint Legislation Review Committee of the Institute of Chartered Accountants and the Australian Society of Accountants, representatives of two firms of accountants (Coopers and Lybrand, and Adrian Ross and Warry), officers of several inter-state law societies, and a number of individual accountants and solicitors in private practice. We gratefully acknowledge the assistance given to us in these ways.

1.12 In addition we commissioned three research reports on matters concerning solicitors trust accounts. First, the Accounting Research Centre at the University of Sydney carried out a survey of present practices of accountants in New South Wales and Queensland when inspecting or auditing solicitor's trust accounts. Secondly, Coopers and Lybrand, a leading firm of accountants, prepared a report on theoretical and practical aspects of auditing solicitors trust accounts. Thirdly, Yarwood Vane & Co., another prominent firm of accountants,[9] provided us with an analysis of their long experience in investigating, at the request of the Law Society of New South Wales, the affairs of solicitors who are

suspected of having mishandled trust moneys. Each of these reports is reproduced in our *Background Paper - V.*

1.13 A Discussion Paper entitled *Solicitors' Trust Accounts and the Solicitors' Fidelity Fund* was published by the Commission in 1981. It described, amongst other things, the current law and practice relating to solicitor's trust accounts in New South Wales, and it made tentative suggestions for change. Submissions in response to the Paper were sought and have been taken into account in the formulation of the final recommendations in this Report.

IV. STRUCTURE OF THIS REPORT

1.14 In chapter 2 of this Report we summarise the principal causes for concern in relation to mishandling of solicitor's trust accounts in New South Wales. In chapter 3 we provide a relatively brief overview of the principal suggestions for reform relating to the solicitor's trust accounts which we canvassed in our Discussion Paper in 1981, and of the responses which those suggestions have evoked from the Law Society of New South Wales as the body principally responsible for the current system. In doing so, we also summarise the main features of that system.

1.15 In the remainder of the Report (chapters 4-11) we consider a number of issues in detail and make our final recommendations in relation to them. The areas with which we deal are:

handling trust moneys (chapters 4 and 5);

recording and accounting for trust moneys (chapter 6);

independent scrutiny of trust accounts (chapters 7-10); and

investing clients' money (chapter 11).

FOOTNOTES

1. Submission and certain other responses are listed in Appendices II and III of our *First Report*.

2. For further details, see *First Report*, para 1.6, note 1.

3. For further details of the inquiries mentioned in this paragraph, see out Discussion Paper, *Complaints, Discipline and Professional Standards - Part I*, and our *Background Papers* I and II.

4. See *Background Papers II, III, IV* and *V*.

5. A report on the results of this survey has been published by the Law Foundation, see R. Tomasic and C. Bullard, *Lawyers and their Work in New South Wales* (1978).

6. Our principle academic consultants are listed in Appendix IV of our *First Report*.

7. The Discussion Papers are listed on p.vii of this Report.

8. The Background Papers are listed on p.vii of this Report.

9. The firm has now merged with, and adopted the name of, Deloitte Haskins & Sells, a large international firm.

2. Principle Causes for Concern

I. INTRODUCTION

2.1 In this chapter we outline the principal causes for concern in New South Wales in relation to mishandling of solicitor's trust accounts. We do so under three basic headings, namely

General Prevalence and Cost of Mishandling

Types of Mishandling

Types of Work and of Practitioner Involved.

2.2 It may be helpful at the outset to explain several central aspects of the present trust account system in New South Wales. We do so in the remaining paragraphs of this introduction.

A. General (or Office) Accounts and Trust Accounts

2.3 Most solicitors in New South Wales use two types of account in the course of their practice. One account, called a *General or Office Account,* is the account in which they deposit *their own* money. This includes, for example, money paid to them by clients for work which they have carried out. The other account, called a *Trust Account,* may be described in broad terms as the account in which they deposit money which is not their own but has been entrusted to them by another person for particular purposes.[1] An example is money paid to a solicitor by the prospective purchaser of a house for the purpose of being paid by the solicitor to the seller at the time of completion of the sale.

B. Solicitors' Fidelity Fund

2.4 The Solicitors' Fidelity Fund is owned and managed by the Law Society.[2] It is used to compensate people who suffer financial loss due to solicitor's dishonest failures to account for money entrusted to them. The Fund was established in 1935, and until 1967 its income consisted solely of compulsory contributions from solicitors. Since 1967 the Fund has had two principal. sources of income, namely interest earned on solicitor's trust accounts and compulsory contributions made to it by all practising solicitors. Between 1968 and 1980 the overwhelming majority of money paid to the Fund came from interest earned on solicitors' trust accounts; contributions from solicitors comprised less than 10 per cent of the Funds total income.[3] In 1981, however, we suggested in our Discussion Paper that solicitor's contributions should comprise a larger proportion of the Fund.[4]

Since that time contributions have been increased very substantially and in 1983-84 they comprised more than one - third of the Fund's total income of $5.2 million.[5]

C. Interest on Solicitors' Trust Accounts

2.5 Interest is earned on solicitor's trust accounts by two different processes. First every solicitors required to deposit each year with the Law Society an amount equal to two-thirds of the lowest balance in his or her trust account during the previous year.[6] This amount is known commonly as the "statutory deposit". The money deposited is then invested by the Law Society and the interest thus earned is paid into a Statutory Interest Account. This Account is owned and managed by the Law Society and, subject to the consent of the Attorney General, can be allocated between the Solicitors' Fidelity Fund, the Legal Services Commission the Law Foundation of New South Wales and purposes which will promote and further legal education.[7]

2.6 Secondly, in early 1983 the Law Society reached agreement with the major banks operating in New South Wales for the payment to the Law Society of interest on solicitor's trust accounts balances.[8] The banks did not agree to be bound to pay any moneys but indicated a preparedness to make "ex gratia" payments. The payments were to represent interest at an agreed rate calculated by reference to the total of the minimum monthly balance of all solicitor's trust accounts held by each bank.

2.7 The Attorney General was advised by the Law Society of the agreements and an interim trust arrangement was proposed to enable the payments made under the agreement to be accumulated and distributed. A trust deed was executed on 3rd February 1984 providing for two trustees nominated by the Law Society and one trustee nominated by the Attorney General to administer a central fund to be known as the Solicitors' Trust Account Fund. The trustees are required to act unanimously. The purposes for which the Fund can be distributed are the same as those applying to the Statutory Interest Account, which we have listed above.

D. The Law Governing Solicitors' Trust Accounts

2.8 The general law relating to trustees applies to solicitors when acting as trustees of other people's money. In addition particular rules governing solicitor's handling of trust moneys are laid down by the Legal Practitioners Act 1898,[9] and the Solicitors Trust Account Regulations made under that Act.[10] The Act defines in general terms the circumstances in which money must or may be paid into, and must or may be paid out of, solicitor's trust accounts. The Regulations consist principally of "book-keeping" rules about the manner in which trust account records must be kept-

II. GENERAL PREVALENCE AND COST OF MISHANDLING

Introduction

2.9 There are compelling reasons for grave public and professional concern about the prevalence and cost of mishandling of solicitors' trust accounts in this State. Each year, hundreds, and probably even thousands, of millions of dollars are entrusted to solicitors. The great bulk of this money is handled satisfactorily but, at least in recent years, very substantial amounts have not been accounted for satisfactorily by the solicitors to whom they were entrusted, and their clients have had to seek compensation from other sources.

Evidence from the Fidelity Fund

2.10 Some idea of the magnitude of the problems which arise can be obtained from the records of the Solicitors' Fidelity Fund for the five-year period to 30 June 1984.[11]

> During that period, the Fund paid a total of $16.5 million to compensate clients for loss of money entrusted to their solicitors.[12]
>
> In addition the Fund spent a total of $9.6 million investigating and handling clients' claims, administering the affairs of aberrant solicitors, paying the Law Society for its attempts to reduce the incidence of mishandled trust funds, and in other ways funding the regulation of solicitor's activities in this area.[13]

In order to finance this expenditure, the Fund received a total of $14.4 million generated by money belonging to members of the public (ie. interest earned on money entrusted to solicitors) and $4.8 million dollars of the profession's money (ie. compulsory contributions). A further $1.4 million was derived from interest on moneys held in the Fund.

2.11 During the same five-year period, there were four instances of the Fidelity Fund re-paying more than $1 million in relation to a particular solicitor's practice.[14] The largest of these repayments was $2.6 million. There were 14 instances of a re-payment to a particular client in excess of $100,000 and the largest re-payment to a single client was $540,000. During the six-year period to 1 st April 1984, repayments were made in relation to 53 solicitors, and in 22 of these instances the total re-payment arising from the solicitor's defalcations was more than $200,000. In a further 12 instances it was between $100,000 and $200,000.

2.12 The position is even more serious than the above statistics indicate. For example, at 30th June 1984 the Fund

> had paid out $2.9 million on claims in the preceding year;
>
> had decided to pay out a further $1.2 million;
>
> had made provision in its accounts for a further $1.5 million which it considered it was likely to pay out on claims already received; and
>
> had a "deficiency of funds" of $2.7 million.

In addition, the Fund's financial statements indicated "contingent liabilities" of $2.8 million comprising

> claims totalling $1.1 million which the fund had received but was disputing or was expecting to dispute; and
>
> intended claims totalling $1.7 million of which the Fund had received notice.[15]

2.13 These heavy demands on the Fidelity Fund have meant that very large amounts of the funds in the Statutory Interest Account and the Solicitors' Trust Account Fund have had to be allocated to the Fidelity Fund rather than to other purposes for which they might be allocated, such as legal aid and legal education.[16] During the five years to 30th June 1984 more than one-third ($14.4 m) of total allocations from these sources went to the Fidelity Fund.[17] Moreover, the profession is now paying more than $1.7 million to the Fidelity Fund each year. This cost forms part of solicitor's overheads and, ultimately must be met from fees paid by clients.

Accordingly, it clearly would be incorrect to regard the Fidelity Fund as a kind of cornucopia that does not really cost anyone anything.

Other Considerations

2.14 As the above statistics demonstrate, many clients whose money is dishonestly mishandled and lost by solicitors subsequently receive re-payment from the Solicitors' Fidelity Fund. However, this re-payment may not always compensate fully for the loss suffered. For example, it may come too late for a client to purchase the house or business which the solicitor was instructed to buy with the money entrusted to him or her. Moreover, the Fund does not provide compensation for the stress suffered by victims nor for the time which they must devote to pursuing their claims for re - payment.

2.15 It must also be borne in mind that the Fidelity Fund figures to which we have referred do not indicate the mishandling which goes entirely undetected, is eventually compensated for by the solicitor (or his or her partners, relatives or friends), or arises from causes other than dishonesty. The Law Society's professional indemnity insurance scheme covers liabilities arising from negligence and other non - dishonest conduct by solicitors.[18] Since its inception in 1980, the scheme has paid out hundreds of thousands of dollars on claims arising from the manner in which solicitors have handled moneys entrusted to them.[19] The cost of meeting these claims is met entirely by premiums set at a standard figure, and therefore is borne by all solicitors no matter how carefully they handle their own trust accounts.

2.16 A further indication of the gravity of the situation in New South Wales can be obtained from statistics of disciplinary action for breaches of the law relating to trust accounts. During the three years to 30th June 1984, 32 of the 33 solicitors who were struck off the Roll had committed breaches of this kind, as had 528 of the solicitors who incurred lesser disciplinary sanctions.[20] It should also be noted that in 1979 the Royal Commission into Drug Trafficking in New South Wales expressed grave concern about the ways in which certain solicitors had allowed their trust accounts to be used to the advantage of drug traffickers with whom they were associated.[21] Similar activities by solicitors in both Australia and New Zealand were mentioned in the report of a subsequent joint Royal Commission into Drug Trafficking in both countries.[22] The Royal Commission on the Activities of the Federated Ship Painters and Dockers Union which conducted Australia-wide investigations, reported in 1984:

> "There is no doubt on a great deal of the evidence before me that certain solicitors have allowed their trust account, if not their strong rooms, to be employed as repositories for monies, the source of which, on any rational view, could only be illegal enterprises. By depositing monies with such solicitors, some hope or expectation is held that law enforcement agencies will have difficulty in locating the funds and in seeking explanations for them."[23]

Recent Trends

2.17 Assertions have been made from time to time over the last five years or so that the level of misappropriation of trust funds is decreasing and the situation is now well in hand. As the following table indicates, however, there seems to be no evidence of sustained improvement.[24]

Solicitors' Fidelity Fund

Year	Claims Paid During Year	Accumulated Balance at End of Year
1978	$1.4m	-$132,000 (deficit)
1979	$1.8m	$159,000
1980	$4.4m	$28,000
1981	$2.8m	$277,000
1982	$1.6m	-$2.2m (deficit)
1983	$4.9m	-$2.5m (deficit)
1984	$2.9m	-$2.7m (deficit)

2.18 There has been a very substantial increase in recent years in the amount of money paid by the Fidelity Fund to the Law Society for the latter's supervisory and educative activities aimed at reducing the incidence of misappropriation. The annual total grew from $820,000 in 1978-79 to $1,777,000 in 1983-84.[25]

Comparison with Other Jurisdictions

2.19 The bad record of losses from solicitors' trust accounts in New South Wales is frequently remarked upon at national, and even international, conferences of lawyers. It shares this dubious distinction with Victoria but in fact records of the last 10 years show that the losses in that State, although very substantial, are well below those in New South Wales. The following table[26] throws light on the record in these States and in several other jurisdictions for the five years 1978-1983.

	Total Claims Paid by Fidelity Fund or Equivalent	**Approximate Number of Solicitors in Practice as at 30th June 1983**
New South Wales	$15,390,062	7,100
Victoria	$2,630,752	5,200
New Zealand	$707,554**	4,500
Queensland	$861,100*	1,900
Western Australia	$75,137	1,100

* figures for five years to December 1984.

** conversion rate as at 30 June 1983: NZ$1.33 = A$1

2.20 Certain aspects of the law and practice relating to solicitors and their trust accounts, and to the Fidelity Fund or equivalent, differ somewhat between the various jurisdictions.[27] Accordingly, considerable caution is necessary when drawing conclusions from the above table. Nevertheless, it is remarkable that in New South Wales the level of Fidelity Fund payments per practising solicitor has been, in recent years, in the order of

four times higher than in Victoria and Queensland; and

more than 10 times higher than in New Zealand.

III. TYPES OF MISHANDLING

2.21 In order to obtain expert information about the types of error which occur in the handling of solicitor's trust accounts, we commissioned the report from Yarwood Vane & Co. to which we referred earlier.[28] This Sydney firm of accountants has had long and detailed experience in the field of solicitor's trust accounts. In the 11 years prior to its report in 1979 the firm carried out no less than 127 investigations of solicitor's trust accounts at the

request of the Law Society.[29] It has continued to be very active in this area and both advised us In 1984 that the report remains valid in the light of subsequent experience.

2.22 We quote below the report's list of "practices which have been found to be in default of present [Solicitors Trust Account] Regulations".[30]

"[A. *Moneys not banked in trust bank account*]

1 .Moneys which should have been banked in the trust bank account have been deliberately banked in the office (or general) bank account; or

2. have been banked in the private bank account of the solicitor or some other bank account under his sole control; or

3. have been paid into a Building Society Account or similar account; or

4. have been used by endorsement for the payment of debts due by the solicitor or some other person; or

5. have been banked in error to the office (or general) account and have remained in that account indefinitely or until the error has been discovered.

[*B. Solicitors Trust Account Regulations not observed in the keeping of trust account books*]

1 .Our concern with the observance of the Solictors Trust Account Regulations is not merely a matter of form because non - observance

(a) implies a disregard for professional obligation that may have further implications, and

(b) creates a situation where the solicitor simply cannot ascertain details of a client's transactions and the balance of funds which should be held for that client in his trust account.

Generally, the breaches of the Regulations occur because the solicitor has not taken the trouble to read and understand what are a very simple and straightforward set of Regulations, or if he has made himself conversant with the Regulations he has failed to ensure that his bookkeeper and/or other employees fully understand and follow the Regulations. There is also the failure to supervise and check from time to time the quality of the work being prepared and its conformity with the Regulations.

2. The most common default is the failure to keep the trust account records strictly in accordance with the Solicitors Trust Account Regulations.

3. In a very small practice the solicitor may keep the records himself and in some cases the quality of the bookkeeping and the hand-writing leaves much to be desired, resulting in inaccuracies and non-observance of the elementary rules of bookkeeping.

4. The books may not be written up regularly or in some cases not for months at a time.

5. Monthly bank reconciliations may be abandoned and prepared at the end of each three months to coincide with the preparation of the trial balance statements.

6. The lack of sufficient particulars to identify transactions is common particularly in the cash book and journal entries.

7. Many less serious breaches occur in relation to the stamping and initialling of the carbon duplicate bank deposit forms by the bank officers and the failure to endorse the date of preparation on the trial balance statements.

[*C. Falsification of trust account books and records*]

1. The payees shown on trust cheques obtained from the solicitor's bank being different from the payees shown in the trust cash book and ledger;

2. Transferring moneys from the trust bank account to the office or other bank account for costs for which no bill of costs has been prepared at the time of the transfer and for which, possibly, no work has been done;

3. Transferring moneys from the trust bank account to the office or other bank account in reimbursement of disbursements which have not been paid by the solicitor and which may never be paid;

4. Overcharging of costs and disbursements;

5. Falsification of trust bank account reconciliations by creating non-existent deposits and drawing moneys from the trust bank account against the fictitious credits, which are allowed to remain as outstanding reconciling items until covered, if they ever are;

6. Transferring moneys from trust ledger accounts in credit to eliminate debits which have occurred by design or error in other trust ledger accounts;

7. Preparation of documents relating to the investment of clients' funds such as mortgages and epitomes, which are false in particulars and where the signatures on mortgages may be forgeries;

8. Clients' title deeds held for them being used as security for unauthorised borrowings sometimes from other clients. The moneys so obtained are often used to cover up shortages in trust funds.

[*D. Law Society Special Account Deposits insufficient or non-existent*]

1. It is often found that solicitors fall to ensure that the deposit is kept up to the level required.

2. Occasionally there is no deposit maintained by the solicitor although one has been required.

[*E. Clients' instructions not observed*]

1. Investment of clients' funds contrary to instructions or without obtaining instructions;

2. Borrowings by the solicitor, members of his family or by companies in which he has an interest without disclosing his interest and advising the client concerned that he should obtain independent legal advice before agreeing to the investment;

3. Failing adequately to secure the investment by registering the mortgage;

4. Investing in other than a first mortgage unless the client has agreed to a lower ranking security;

5. Failing to inform clients of the investment of their funds in what is known as 'contributory mortgage' and failing to prepare deed of trust if the solicitor is shown on the mortgage as the mortgagee;

6. Failing to obtain a valuation of the property on which the loan is secured to ensure that the client's loan is within the recognised limits disclosed by the valuation;

7. Failing to ensure that a current and adequate insurance cover is maintained on the property if insurance is required;

8. Using clients' funds, held for conveyancing matters and for estates of deceased clients, etc., temporarily for the benefit of other clients without the consent or knowledge of the clients whose funds are used."[31]

2.23 Our other principal sources of information about types of mishandling are the judgements of the Solicitors' Statutory Committee in disciplinary cases involving trust accounts, two statistical surveys of complaints made about lawyers to the Law Society and the Law Reform Commission respectively,[32] and discussions with officers of the Law Society.[33] These sources, together with the report by Yarwood Vane & Co., lead us to conclude that in recent years the most prevalent and serious types of mishandling have included

transferring from trust accounts to general accounts moneys which are incorrectly believed, or alleged, to be due for costs and disbursements;

investing clients' money without instructions or contrary to instructions;

borrowing money from clients without disclosing that it is for the personal use of the solicitor (or a relative or associated company) and without advising the client to obtain independent legal advice.

IV. TYPES OF WORK AND OF PRACTITIONER

2.24 The report by Yarwood Vane & Co. also included comments about whether some types of work and of practitioner are more likely than others to give rise to mishandling.

"Our experience is that it is not possible to draw a character picture of a solicitor, or a class of solicitors, likely to default.

In the 1970's, however, it is clear that some solicitors, seeing profits to be made and being made by the clients in a booming real estate market, were tempted to try their hand at speculating, using their clients' money for that purpose.

When a slump came in the land market they were, of course, caught as were all speculators with inadequate capital.

Hence, one class of solicitor deserving attention perhaps would be one known to be interested in real estate or with a close connection with land speculators or even real estate agents.

It is possible that the sole practitioner is more vulnerable to the temptation provided by his position of trust than one in partnership with others. Partners tend to know what each other are doing, although we have dealt with cases where this has not been so.

Another vulnerable class of a solicitor is the ageing sole practitioner who has enjoyed a reasonably high standard of living most of his life and his personal spending habits may have become inappropriate to his present earning capacity."[34]

2.25 This aspect of the report - in conjunction with other sources of information lead us to identify two principal areas of concern First - there is the high incidence of mishandling by sole practitioners. More than 60 per cent of the 33 solicitors struck off the Roll in the three years to 30th June 1984 for matters relating to trust accounts were sole practitioners, yet sole practitioners comprised less than 20 per cent of all practising solicitors in the State.[35] Our statistical surveys of complaints made about lawyers during the mid - and late-1970s indicated that the great majority of complaints about investment of clients' money, and almost 50 per cent of complaints about trust funds, related to sole practitioners.[36] Our investigations do not indicate that these proportions have changed substantially in more recent times. It must be borne in mind, however, that in some instances mishandling by a partner may not give rise to a complaint to the Law Society or to a disciplinary charge because other partners remedy the situation from their own resources.

2.26 Secondly, there is the prevalence of mishandling in the course of investing clients' money, especially where solicitors conduct another business enterprise (such as that of land speculator, property developer, financier or mortgage broker) in association with their legal practice. These associated activities can give rise to real or apparent conflicts between the respective interests of solicitors and their clients. Thirty-four (62 per cent) of the solicitors struck off the Roll in the five years to 30th June 1984 were charged with matters arising from investment of clients' moneys.[37] In 25 of these 34 cases an associated business enterprise of the solicitor was involved.[38] Our statistical survey of complaints to the Law Society in the mid - and late 1970s found that 22 out of 24 complaints about trust funds related to investment of clients' money.[39] Our survey of complaints made to us in 1977 and 1978 about lawyers found that 30 per cent of complaints about investment transactions alleged that the solicitor involved had a conflict of interest.[40]

2.27 The report by Yarwood Vane & Co. drew particular attention in this context to "the ageing sole practitioner." Our statistical survey of complaints made to the Commission in 1977 and 1978 found that all of the complaints about investment of clients moneys, and about three-quarters of those about trust funds generally, were in relation to practitioners of at least 15 years standing.[41] It is not clear how many of these practitioners were in sole practice.

2.28 Yarwood Vane & Co. also threw light in their report on personal characteristics, difficulties, and motivations which may lead solicitors into trouble with their trust funds.

"The character traits most commonly found appear to emanate from -

Deliberate fraud

Cupidity

Gambling

Philanthropy

Laziness

Carelessness

Stupidity

Some of these weaknesses may have been inherent in the solicitors' characters; they may also have been triggered by the many mental and physical ills which beset mankind, such as -

Nervous disorders resulting in nervous breakdowns and paranoia,

Alcoholism and drugs,

Marital problems,

Blackmail,

Accidents to themselves and their families, illness and disease in all its forms, and also to business reversals and economic recessions.

Although our experience in relation to the above is confined to members of the legal profession, this cannot be construed as an indictment of the members of that profession as the percentage of the discovered transgressors is very small compared with the total number in practice.

The weaknesses observed are also found throughout the community ...

There have been the cases where the solicitor has not been the guilty party, but due to his neglect carelessness, lack of supervision or misplaced trust, the moneys under his control have been stolen by his employees and sometimes by his partner.

The incidence of *philanthropy is* an interesting phenomenon which has been found on many occasions where the solicitor has, no doubt with humane intentions, made loans, in some cases of large sums, to clients for various reasons such as -

Bridging finance for home purchases;

Advances in workers compensation and traffic accident cases before verdicts have been given;

Advances to beneficiaries in deceased estates, sometimes before a grant of probate;

Advances to deceased estates to pay death and estate duties by due date so as to avoid interest penalty;

For the clients private use to settle debts and other pressing commitments.

In these cases, the solicitor's motives were no doubt charitable, not at his own expense but at the expenses of his clients generally, whose funds happened to be in the trust account at the time."[42]

FOOTNOTES

1. In some circumstances money belonging to the solicitor maybe paid into the trust account - For example, where a client pays by one cheque a sum of money which is owed to the solicitor and another stun which is being entrusted to the solicitor for a particular purpose.

2. Legal Practitioners Act 1898, ss.45,5 1. See also our Discussion Paper, *Solicitors' Trust Accounts and the Solicitors' Fidelity Fund* (hereafter referred to as "Discussion Paper"), chs.5.9.

3. See our Discussion Paper, para. 10.16.

4. *Id.,* at paras.10.9-10.42.

5. See Law Society of N.S.W., *Annual Report 1983-84,* p.30. The Annual Report is printed in the *Law Society Journal* (Oct. 1984), vol.22, no.9.

6. Legal Practitioners Act. 1898, s.42A (3AA). See also our Discussion Paper, paras.10.2-10.4.

7. Legal practitioners Act 1898, s.44A.

8. This and the following paragraph rely on information provided by the Attorney General's Department. The terms of the arrangements with the banks, and of the trust deed, have not been made public.

9. See especially ss.41-44.

10. The current Regulations are reproduced in Appendix II of this Report.

11. The Fund's financial statements, from which statistics in this and succeeding paragraphs are derived. are contained in the Annual Reports of the Law Society of New South Wales which are printed each year in the October edition of the Law Society Journal.

12. These totals represent the net cost to the Fund - ie. moneys recovered by the fund and applied to repayments to clients have been deducted.

13. Expenditure of these kinds is said to be authorised by s.49 of the Legal Practitioners Act, 1898.

14. Statistics in this paragraph are derived from information provided to the Commission by the Law Society.

15. This latter total includes amounts payable if the Society exercises its discretion under the Legal Practitioners Act, 1898 (s.57A) to meet in full any claims against a solicitor which, in total, exceed $200,000. It is the Policy of

the Council that, where possible, all claims should be paid in full and, to date, it has always done so although full payment has sometimes been delayed for lengthy periods.

16. See para.2.5 above.

17. $14.4 million out of a total of $40.3 million. Allocations from the Statutory Interest Account are published in the Annual Reports of the Society of New South Wales (see note 2.10.1 above). Allocations from the Solicitors' Trust Account Fund to the Solicitors' Fidelity, Fund began in the year ending ; 30th June 1984 and were published in the Annual Report for that period.

18. In relation to the scheme generally, see our Discussion Paper. *Professional Indemnity Insurance* (1979).

19. See also para.11.2 below.

20. Statistics supplied by the Law Society of New South Wales at the request of the Commission.

21. See, eg. *Royal Commission into Drug Trafficking* (the Woodward Commission), *Report* (1979), pp.1123-1132, 1182-1186, 1235, 1286-7, 1301-2, 1305-6, 1314, 1316 and 1324.

22. See Royal Commission of Inquiry into Drug Trafficking, *Report* (1983), eg. at pp.619, 630.

23. *Final Report* (1984), vol.2. para 8.003.

24. The table is derived front Annual Reports of the Fidelity Fund (see note 2.10.1 above).

25. See note 2.1.1 above.

26. This table is derived from the Annual Reports of the Fidelity Funds in the jurisdictions in question and from information provided by the various law societies.

27. For example, the definition of the types of claim which may be made on the Fidelity Fund, and the procedure for establishing the claim, differs between jurisdictions. See our Discussion Paper, *Solicitors' Trust Accounts and the Solicitors Fidelity Fund* (1981), esp. chaps. 9, 11 and 12.

28. Yarwood Vane & Co, "Study and Analysis of Available Experience of Investigation of Solicitors in Default of Trust account Regulations" (1979).

29. *Id*, p.7.

30. *Id*, p.10.

31. *Id*, pp.10-16.

32. The two surveys are reported in our *Background Paper - III*. On matters referred to in this paragraph see, in particular, pp.58, 61, 107, 120, 121 and 55 of that paper.

33. See also a paper by a Law Society officer, Mr. K. Garling, in University of Sydney Institute of Crime and the Professions - The Legal Profession (1983).

34. Yarwood Vane & Co. Report (see note 2.21-1 above). pp.9-10.

35. Information supplied by the Law Society at the request of the Commission.

36. Background Paper - III, pp.70, 154.

37. Figures supplied by the Law Society it the request of the Commission.

38. *Id*.

39. *Background Paper - III*, p. 155,

40. *Id*., p.61.

41. *Background Paper - III*, pp.63, 64.

42. Yarwood Vane & Co. Report (see note 2.21.1 above), pp. 7-9.

3. Our Earlier Suggestions for Change

I. INTRODUCTION

3.1 The purpose of this chapter is to provide a relatively brief review of the principal suggestions for reform which we made in our Discussion Paper in 1981, and of the responses which those suggestions have evoked from the Law Society as the body principally able for the current system. In doing so, we also summarise the main features of that response system. Further details of the current system, our suggestions for change, and subsequent responses are given in later chapters.

3.2 The chapter is divided into the following sections:

Handling Trust Money;

Recording and Accounting for Trust Money;

Independent Scrutiny of Trust Accounts; and

Investment of Clients' Money.

We adopt the same division later in this Report when looking at the issues in greater detail and making our final recommendations.

II. HANDLING TRUST MONEY

3.3 Solicitors are required by law to pay certain money into a trust account in a bank. The principal statutory provision is as follows:

> "All moneys received in New South Wales for or on behalf of any person by any solicitor shall be held by him exclusively for such person, to be paid to such person, or to be disbursed as he directs, and until so paid or disbursed the moneys shall be paid into a bank in New South Wales to a trust account, whether general or separate." (s.41(1), Legal Practitioners Act, 1898).

3.4 This provision gives rise to a number of questions about the receipt and payment of money by a solicitor. We considered these questions in our Discussion Paper and made a number of tentative suggestions for change or clarification of the existing law. A goal underlying many of these suggestions was the introduction of greater

clarity and formality into the handling of trust money, especially in situations where difficulties may arise in distinguishing between money which rightly belongs to the solicitor and money which has been entrusted to him or her by a client. They also concentrate on aspects which our investigations, and especially information provided by the Law Society and Yarwood Vane & Co.,[1] indicate as common sources of difficulty.

A. Paying Money into Trust Accounts

3.5 Our principal suggestions concerning receipt of money were as follows. First, we suggested that the requirement to pay into a trust account should be explicitly confined, as it has been by accepted practice, to money received while acting either as a solicitor or in connection with practice as a solicitor. We proposed a specific statutory definition for this purpose.[2]

3.6 Secondly, we suggested that where a solicitor receives money for costs (ie. professional fees) and disbursements (ie. out-of-pocket expenses) to which he or she has not yet become entitled, the money should have to be paid into a trust account.[3] In connection with this suggestion we proposed that in the absence of specific agreement to the contrary between solicitor and client, a solicitor should not become entitled to costs until he or she has rendered a bill (not necessarily in detailed form) but should be entitled to disbursements as soon as they are made, provided that they were made on the client's instructions.[4]

3.7 Thirdly, we suggested that solicitors should be entitled in specified circumstances not to pay money into a trust account, even though they have received it on trust rather than as their own.[5] This would apply, for example, where the money's received in cash on trust for a client and is passed on as cash to the client without delay. We referred, however, to the possibility of requiring solicitors to keep a written record (perhaps known as a Direct Payments Register) of all their dealings with money that is entrusted to them but not paid into their trust account.

3.8 Fourthly, we suggested that, in order to avoid possible confusion, solicitors should not be permitted to pay into a trust account any moneys belonging to them personally, such as money paid for costs and disbursements to which they have already become entitled.[6] We proposed an exception in relation to a cheque which is partly money belonging to the solicitor and partly money entrusted to him or her for the client s purposes.

3.9 The Law Society responded to our Discussion Paper in December 1981.[7] It did not disagree fundamentally with the first three suggestions referred to above, although it proposed certain amendments.[8] The Society did, however, disagree with the fourth suggestion. It considered that solicitors should be entitled to keep some of their own money in their trust account.[9] As we explain later in this Report the present law on this question has been clarified somewhat by the Court of Appeal in a decision handed down after our Discussion Paper, and the Law Society's response thereto, had been published.[10]

B. Withdrawing from Trust Accounts

3.10 We canvassed in the Discussion Paper the possibility of requiring that withdrawals from a trust account be made only upon written direction of the person on whose behalf they were received.[11] We did not, however, suggest adoption of a general requirement of this kind.The Law Society agreed with this view.[12]

3.11 We also considered questions concerning solicitors paying money from their trust account to their general account for costs or disbursements. We suggested that such payments should be permissible only where either

(a) they are authorised in writing by the client; or

(b) (i) in the case of costs, a bill has been rendered and the client has had one month in which to object to it; or

(ii) in the case of disbursements, they were made on the client s instruction.[13]

The Law Society considered that these restrictions were excessive (principally, it would seem, in relation to the "one month" requirement) but on the other hand could be evaded readily by requiring clients to sign standard written authorisations at the outset.[14]

III. RECORDING AND ACCOUNTING FOR TRUST MONEYS

A. Computerised Accounting

3.12 Solicitors are subject to detailed rules concerning the manner in which trust account records are to be kept. Most of these rules are contained in the Solicitors Trust Account Regulations,[15] which were developed for manual systems of accounting. Although capable of application to some mechanical systems, they are unsuited to systems using electronic data processing, which are becoming increasingly common in solicitors' firms and elsewhere in the community.

3.13 In our Discussion Paper we indicated our agreement with the Law Society's view that the existing Trust Account Regulations need extensive re-drafting in order to both accommodate and regulate modern electronic accounting methods.[16] We considered, however, that the regulations should remain specific in nature rather than as the Law Society proposed, doing little more than require that solicitor s accounting systems must be approved by the Society. Two sets of draft regulations, one embodying our suggested approach and the other drafted by the Law Society, were reproduced in our Discussion Paper.[17] The Society adheres to its view as to the appropriate form of regulations for this purpose.[18]

B. Statements of Account

3.14 Where solicitors receive money on behalf of clients in relation to claims arising from death or personal injury, they are required, broadly speaking, to provide the clients within a specific time with a statement of account indicating in an auditable form the amount received and the manner in which it has been disbursed.[19] We suggested in our Discussion Paper that this obligation should be extended to require solicitors to send a statement of account to each client from whom or on whose behalf they have received money on trust, irrespective of whether a claim arising from death or personal injury was involved.[20] We also suggested that such a statement should have to be sent at quarterly intervals as well as at the completion of the matter. The Law Society agrees that a statement should have to be sent upon completion but does not believe that quarterly statements should be required.[21]

IV. INDEPENDENT SCRUTINY OF TRUST ACCOUNTS

A. A Basic Issue

Accountants' Examinations

3.15 At present solicitors are required to provide the Law Society with an annual report by a public accountant who has examined their trust accounts.[22] The report must deal with certain specified matters and, amongst other things, must state whether the accountant considers that the trust account records are "of the nature and in the form" required by the Trust Account Regulations and "appear to have been regularly written up and properly kept.[23] Solicitors are required to keep their accounts in such a form as "to enable them to be conveniently and properly audited",[24] but they are not required to have them audited.

3.16 It is generally accepted by both solicitors and accountants that the type of accountant's examination that is currently required is not very rigorous and certainly does not involve as much scrutiny as would an *audit* conducted in accordance with the general legal principles and professional accounting standards which apply to audits. The differences between the current type of accountants' examinations and audits are considered in greater detail in chapters 7-10 below.

Law Society Inspections

3.17 The Law Society maintains a staff of inspectors who undertake random inspections of solicitors trust accounts throughout the State and inspections of trust accounts which the Society believes may not be in order. These inspections are conducted in accordance with internal Law Society procedures and culminate in reports to the Society which usually concentrate upon whether the trust account records comply with the "book-keeping" requirements of the Solicitors Trust Account Regulations.[25]

Suggestions for Change

3.18 In our Discussion Paper we suggested that the current type of accountant s examination does not provide sufficient scrutiny and that, in the interests of clients, the general public and the profession itself, accountants should be required to audit the trust accounts rather than merely examine them.[26] We suggested also that Law Society inspections should be more “intensive” and “concentrate more on substance than form”, and that Law Society inspectors should be given wider powers of investigation.[27] We did not consider, however, that it would be practicable or desirable for the independent scrutiny of trust accounts to depend solely on Law Society inspections to the exclusion of accountants’ examinations or audits.

3.19 The Law Society responded that the accountants exammination requirements should be made “more rigorous and demanding” in certain ways which it outlined, and that inspections by the Society’s own inspectors should become more frequent and thorough, but that audits should not be required.[28] The Society has subsequently introduced more frequent (and somewhat more thorough) inspections by its own staff. Since 1982 the Society’s inspectorial staff has increased from 7 to 12,[29] and in 1983 the Society adopted as a goal, which it has almost achieved, that every solicitor’s practice in the State should be inspected each year.

B. Ancillary Issues

3.20 Having suggested in our Discussion Paper that annual audits should be required, we then considered a number of ancillary issues. We mention some of them here and discuss them in detail in chapters 9 and 10 below.

3.21 First, we suggested that, in addition to the general checks and reports which are inherent in the nature of an audit, the auditor should be subject to certain specific statutory requirements.[30] For example, he or she should be required to

make an unforeshadowed examination of the records on at least one occasion each year;

report any transaction between the solicitor (or associated company) and a client; and

report whether he or she has checked the solicitor’s system of transferring money for professional costs from the trust account to the general account

No such requirements currently apply to accountant s examinations. The Law Society said that it did not oppose some of these suggestions, but it expressed no opinion about others.[31]

3.22 Secondly, we suggested that generally speaking, any registered public accountant should be eligible for appointment by a solicitor to act as his or her auditor, but that notices of appointment and termination of appointment should have to be given to the Law Society, and the Society should be entitled (subject to appeal to the Supreme Court) to refuse to accept reports from particular nominated auditors whom it considers to be sub-standard.[32] At present, accountants who are responsible for the annual examination and report in relation to a particular firm commonly do general accounting work for that firm as well We suggested that, in order to have demonstrable independence in their auditing role, accountants should not be permitted to do any other professional work for solicitors for whom they are conducting the prescribed annual audit.[33] The Law Society

disagreed with this latter suggestion and also said it did not wish to have power to reject certain nominated auditors.[34]

3.23 Thirdly, we suggested that solicitors should be required to open and retain files in relation to all work which involves the handling of money entrusted to them.[35] This proposal was aimed at enabling auditors to establish necessary background to entries in the trust account records. Accordingly, we suggested also that auditors should have access to these files, where necessary, in order to facilitate their examination of the trust account records concerning the client and matter to which the files relate.[36] We suggested also that auditors should have access to solicitors' general accounts[37] in order to check the accuracy of entries in the trust account records and to establish whether all money which should have been paid to the trust account was so paid. The Law Society agreed with the latter suggestion but said that it was not persuaded that the suggested requirements about opening and retaining files were warranted.[38]

3.24 Fourthly, we suggested that auditors should be empowered to seek verification from a solicitor s clients of the correctness of particular trust account records relating to them, and should be required to report whether such verification has been sought.[39] The Law Society agreed with this suggestion[40] and subsequently has conducted limited experiments with client verification procedures. These are discussed in chapter 10 below.

V. INVESTMENT OF CLIENTS' MONEY

A. Introduction

3.25 Solicitors in New South Wales are commonly asked by clients to play some role in investing the latter s money. Often the intended investment is a loan secured by a mortgage.

3.26 In some instances the money is received and invested by the solicitor through the solicitors' trust accounts. Accordingly, it must be dealt with in accordance with the rules applying to those accounts and is subject to independent scrutiny of the type described earlier in this chapter. In other instances, however, the money is received and invested by a nominee company, or private finance company, which is controlled by the solicitor. Such companies are not subject to the system for regulation of solicitors' trust accounts nor, at least in relation to nominee companies, to the regimes of control applicable to, for example, banks, building societies or public finance companies.[41]

3.27 It is not known precisely how much money is invested by one or another of these methods in New South Wales but it undoubtedly runs into tens, or even hundreds, of millions of dollars each year. As we mentioned earlier,[42] investment transactions of these kinds, especially those where a nominee company or private finance company is involved, have been a major source of losses to clients in recent years as a result of dishonest or negligent action by solicitors.

3.28 In our Discussion Paper we identified four principal reforms which might be introduced in this area, namely

tighter controls over the structure and operation of solicitor's nominee companies;

tighter controls over the structure and operations of solicitors private finance companies or a prohibition of such companies;

a compulsory register of all investment transactions involving solicitors, their nominee companies or their private finance companies; and

a requirement that no withdrawals from solicitors' trust accounts for the purposes of investment should be made without written directions from the client.

B. Nominee Companies

3.29 The nature and purposes of solicitors' nominee companies are discussed in chapter 11 below. They are, in essence, intended purely to facilitate lending and borrowing procedures, especially where there are multiple contributors to one loan. They usually have nominal assets only and earn no income.

3.30 We suggested in our Discussion Paper that these companies can fulfil valuable functions but should be subject to the rules applying to solicitor's trust accounts, including the proposed audit requirement.[43] We also suggested certain special rules governing their accounts and their relationship with solicitors trust accounts. We suggested that they should be owned and operated solely by solicitors (or members of their family) and that actions of the company should be regarded as also being actions of the solicitors and thus subject to professional rules and discipline.

3.31 The Law Society indicated broad support for our suggestions concerning nominee companies and subsequently proposed detailed draft regulations on the subject.[44]

C. Private Finance Companies

3.32 We discuss in chapter 11 the nature, purposes and operations of solicitors' private finance companies. These companies were common in New South Wales during the 1970s. One of their principal features was that, since solicitors usually sought to make a profit through these companies by lending money at higher interest rates than they paid to the client from whom they borrowed it, there was a considerable likelihood that when advising or acting for their clients in relation to the transaction they might be affected by a conflict between their own interests and those of their clients. This danger was aggravated if, as was not uncommon. the private finance company made substantial loans to people, or business enterprises (such as property development companies), that were closely associated with the solicitor. In 1979, however , the Law Society introduced certain restrictions on the operation of private finance companies, one of the purposes of which was to prevent such conflicts of interest from arising.[45]

3.33 In our Discussion Paper we canvassed the possibility of prohibiting solicitors from operating private finance companies.[46] We suggested, however, that rather than being prohibited they should be subject to the same controls on their structure and operations as we had suggested for solicitors' nominee companies, and to certain other rules including a requirement that the solicitors personally guarantee repayment of money deposited with their companies. We also raised the possibility of certain other controls such as specified minimum assets/liabilities ratios, and prescribed criteria for securing loans.

3.34 The Law Society said that it did not necessarily disagree with many of our suggestions but that they needed further discussion.[47] The Society subsequently made inquiries of each solicitor in the State in order to ascertain the prevalence of private finance companies and apparently concluded from the responses that by 1982 they had become very rare and accordingly there was no pressing need for tighter controls.[48]

D. Register of Investments

3.35 Investment transactions by solicitors on behalf of clients are not always recorded by them in such a way that they can be conveniently and effectively audited. Neither the solicitor nor, more importantly, the client may have a clear record of what has happened and what their respective rights and duties are.

3.36 In our Discussion Paper we suggested that solicitors should be required to record in a special register prescribed details of all securities and investments relating to mortgage transactions which involve them, their nominee companies or their private finance companies.[49] The Law Society subsequently suggested extending the proposed register to cover not only mortgages but also "any other transaction regulating the lending of money, whether on a secured or unsecured basis where the solicitor is the lender or is authorised to receive re-payments.[50] The Society envisaged that the requirement should apply also to solicitors' nominee companies and perhaps to their finance companies.

E. Written Directions

3.37 As mentioned earlier,[51] solicitors are not required to have written directions from clients in order to make payments from their trust accounts. One of us suggested in the Discussion Paper that, in light of the serious confusion and losses which have arisen from withdrawals made by some solicitors for the purposes of investment, no withdrawals for those purposes should be permitted without the client s written directions in advance.[52] The Law Society subsequently proposed a draft regulation which would require written directions in a wide range of investment transactions.[53]

FOOTNOTES

1. See chapter 2 above.

2. See Discussion Paper, paras.4.10-4.20.

3. *Id.,* paras.4.26-4.39.

4. *Id.,* paras.4.39, 4.73.

5. *Id.,* paras.4.45-4.48.

6. *Id.,* paras.4.49-4.52.

7. “Solicitors’ Trust Accounts and the Solicitors’ Fidelity Fund” (1981) (hereafter referred to as “Law Society’s Response”).

8. *Id*., paras.2.1-2.8.

9. *Id*., para.2.9.

10. See paras.5.7-5.11.

11. Discussion Paper, paras.4.54-4.58.

12. Law Society’s Response, para.2.10.

13. Discussion Paper, paras.4.59-4.73.

14. Law Society’ s Response, para.2.11.

15. Made under the Legal Practitioners Act, 1898.

16. Discussion Paper, paras.5.14-5.27: Law Society of N.S.W., “Statutory Interest Account and Solicitors’ Trust Accounts” (Submission to N.S.W. Law Reform Commission 1979), p.14.

17. See Discussion Paper, Appendices I and 11.

18. The Society’s current draft is reproduced in Appendix III of this Report. In relation to “book-keeping” regulations intended to accommodate computerised accounting, it does not differ significantly from the draft published in our Discussion Paper.

19. Solicitors (General Regulations, reg.28 (made under the Legal Practitioners Act, 1898).

20. Discussion Paper, paras.6.42-6.45.

21. Law Society’s Response, para.4.5.

22. Solicitors Trust Accounts Regulations, reg.8.

23. *Id*., Schedule, Form No.1 (see Appendix II to this Report).

24. Legal Practitioners Act, 1898, s.42(2).

25. See, in particular, the Law Society’s Check-List for Inspectors.

26. Discussion Paper, paras.6.3-6.23, 6.46-6.63.

27. *Id*., paras.6.24-6.34.

28 .Law Society’s Response, paras-5.1-5.5.

29. Information supplied by the Law Society at the request of the Commission.

30. Discussion Paper, paras.6.71-6.76.

31. Law Society's Response, para.5.12.

32. Discussion paper, paras.6.64-6.68.

33. *Id*., paras.6.69-6.70.

34. Law Society's Response, paras.5.10-5.11.

35. Discussion paper, paras.6.79-6.84.

36. *Id*., paras.6.79-6.80.

37. *Id*., paras.6.85.

38. Law Society's Response, paras.5.15-5.18

39. Discussion Paper, paras.6.76, 6.87-6.81.

40. Law Society's Response, para.5.20.

41. See paras. 11.31, 11.38 below.

42. See paras.2.22-2.23 above.

43. For the suggestions in this paragraph, see Discussion paper, paras. 7.11-7.18.

44. Law Society's Response, paras. 6.2-6.3; and see draft Solicitors Trust Account Regulations, reg. 15, in Appendix III of this Report.

45. See paras. 11.5, 11.6, 11.40 and 11.41 below.

46. For the suggestions in this paragraph, see Discussion Paper, paras.7.19-7.39.

47. Law Society's Response, paras. 6.4-6.5.

48. See para 11.43 below.

49. Discussion Paper, paras. 7. 40, 7.46.

50. Law Society's Response, para. 6.6 See also draft Solicitors Trust Account Regulations, reg,15, in Appendix III of this Report.

51. Para. 3.10 above.

52. Discussion Paper, para 4.57.

53. See draft Solicitors' Trust Account Regulations, reg.14, in Appendix III of this Report.

4. Handling Trust Money: General

I. INTRODUCTION

4.1 In this and the next chapter we consider aspects of the law and practice relating to the handling of trust moneys by solicitors. We do so under the following headings:

Paying Money into Trust Accounts (chapter 4, section II)

Withdrawing Money from Trust Accounts (chapter 4, section III)

Issues Relating to Professional Costs and Disbursements (chapter 5)

In relation to each issue considered, we describe the present position in New South Wales, discuss whether or not there is a need for reform, and make specific recommendations.

4.2 Existing legislation in New South Wales about solicitors' trust accounts[1] is less extensive and specific in relation to the handling of trust moneys than the corresponding legislation in many other jurisdictions (notably Queensland,[2] England,[3] Ontario,[4] New Zealand,[5] and, to a lesser extent, Tasmania).[6] We have pointed out in chapter 2 that trust account mishandling appears to be markedly more prevalent in New South Wales than in these other jurisdictions. This comparison reinforces our view that there is much to be gained from a close analysis of the rules in these other jurisdictions, and we make frequent reference to them in this chapter. When we make general comparisons with " other Jurisdictions we are referring to the Australian jurisdictions other than New South Wales, and to England, Ontario and New Zealand.

II. PAYING MONEY INTO TRUST ACCOUNTS

A. Introduction

4.3 Clear distinctions are made in some trust account legislation, notably in Ontario,[7] between moneys which, respectively, *must, need* not and must not, be paid into a solicitors trust account. We regard these distinctions as helpful, both in discussion and in legislation, and we adopt them in this chapter.

B. Money which Must be Paid into a Trust Account

4.4 In this section we look at the following issues:

the capacity in which money is received;

the receipt of money outside New South Wales; and

the time within which money must be paid into a trust account.

The Capacity in which Money is Received

4.5 **The Present Position:** The money which is required by law to be paid into a solicitors' trust account is money which is received "for or on behalf of any person by any solicitor".[8] By contrast, the Solicitors' Fidelity Fund's responsibility to repay losses caused by solicitors' dishonest failure to account, applies to any money entrusted to a solicitor" in the course of his practice as a solicitor (including any money ... entrusted to him as a solicitor-trustee).[9] The compulsory professional indemnity insurance scheme covers solicitors' liability for losses caused by them other than through dishonesty, provided that the losses arose from "the business of practising as a solicitor' which is defined in the Master Policy as" including the acceptance of obligations as Trustee, Executor, Attorney-under-Power, Tax Agent or Company Director provided that "any fees or income...there from ... inure to the benefit of the solicitor".[10] There is some case law about the meaning of such phrases as "in the course of practice as a solicitor", but considerable uncertainty and ambiguity remains.[11]

4.6 **Discussion:** There can be little doubt that solicitors should not be required to pay into their trust accounts money which they receive in a capacity, such as treasurer of a musical society, that is entirely separate from their practice as a solicitor. The present law in this State would probably be interpreted to that effect but it is not entirely clear since it merely refers to money received by "any solicitor" for or on behalf of "any person" (rather than, for example, any client'). Problems of a more serious nature can arise, however, because there are many capacities in which solicitors may receive money for or on behalf of people, and it is often difficult to determine whether the money was received in the capacity of solicitor or in the capacity of, say, trustee, agent, stakeholder, bailee, company director or mortgage broker or in the capacity of solicitor and also one or more of these other capacities. Accordingly, there may be doubt about whether the money must, indeed even *must,* be paid into the solicitors' trust account.

4.7 People entrusting money to solicitors are commonly aware in a general sense of the professional qualifications which solicitors must acquire, and of the system of regulations to which solicitors are subject both generally and specifically in relation to the handling of money. Indeed, the Law Society of New South Wales gives prominence to these matters in promotional and educational material published on behalf of its members. It seems reasonable to conclude that in many cases this awareness plays a significant part in decisions to entrust money to solicitors. Yet such decisions are commonly, and understandably, made without considering whether the particular transaction is within an area of work to which the special regimes of qualifications and regulation apply. Even if consideration is given to this question there may be great difficulty under the present law in determining the answer.

4.8 We have mentioned above the differing terminology used to define the ambit of protection provided by the trust account regime, the Fidelity Fund and the compulsory professional indemnity insurance scheme. Anomalies and injustices may arise from such differences. For example, it may be considered anomalous that certain

moneys do not have to be paid into a solicitor s trust account yet are protected by the Fidelity Fund scheme, or vice versa.

4.9 Several possible alternatives to the current wording of the trust account provisions in this State can be drawn from equivalent provisions in other jurisdictions. The possibilities include expressions such as

> in the course of practice as a solicitor";[12]
>
> in connection with, practice as a solicitor";[13] or
>
> in the course of acting as a solicitor, or of acting, in connection with practice as a solicitor, as a trustee, agent, ballee, stakeholder or in any other capacity."[14]

In our Discussion Paper we suggested wording somewhat akin to the third of these options.[15] The Law Society subsequently indicated that it had "no objection in principle" to this suggestion.[16]

4.10 **Recommendation:** In our view, the circumstances in which money received by a solicitor is subject to the special regime of solicitors' trust account regulations should be defined as clearly as possible. Some degree of vagueness may be unavoidable, but at the least the definition should deal specifically with some of the common circumstances about which uncertainty might otherwise arise. It is important, also, that the definition, and thus the protection afforded to the public, should be generously drawn. It should, we believe, cover those circumstances in which some people entrusting money to a solicitor are likely to have been motivated to a significant extent by the fact that the person is a solicitor. We foreshadow in this context a later recommendation[17] that, generally speaking, people should be entitled, by written directions, to instruct a solicitor that their money is to be dealt with in some way other than payment into the solicitor's trust account. This avoids what might otherwise be a disadvantage of a broad definition of the circumstances in which solicitors must pay money into their trust accounts.

4.11 **Accordingly, we recommend that solicitors should be required to pay into their trust accounts any money entrusted to them "in the course of acting as a solicitor or of acting, in connection with their practice as a solicitor, in the capacity of trustee, agent, bailee, stakeholder, mortgage broker, company director or any other capacity".** This would require an amendment to section 41(1) of the Legal Practitioners Act, 1898. It would also be desirable for the Law Society to develop guidelines for the interpretation of this provision in particular contexts. We are inclined to the view that the respective ambits of the Fidelity Fund scheme[18] and the compulsory professional indemnity insurance scheme[19] should be similar to those of the trust accounts regime, but it is beyond the scope of this Report to make firm recommendations about those areas. The question of money received not by a solicitor as such but by a company which he or she controls is considered in a later chapter dealing with a range of issues about such companies.[20]

Money Received outside New South Wales

4.12 **The Present Position:** The requirement that New South Wales solicitors must pay money into a trust account applies only to money received by them "in New South Wales".[21] If they receive money in another State

or Territory in the course of practising as a solicitor of that jurisdiction, they are subject to the trust account legislation of that jurisdiction But it is neither uncommon nor necessarily illegal for New South Wales solicitors to receive money in a jurisdiction in which they are not admitted to practice, or to receive it in a jurisdiction where they are admitted and have a practice but the particular money in question is received in the course of practising as a New South Wales solicitor. It seems that in each of these situations the receipt and handling of the money is not governed by any existing legislation, whether of New South Wales or the other State or Territory dealing with solicitors trust accounts.

4.13 **Discussion:** There seems little doubt that if a solicitor is entrusted with money in the course of, or in connection with, practice as such, the manner in which he or she handles the money should be governed by solicitors' trust account legislation. But should it be governed by legislation of the Jurisdiction in which it is received or of the jurisdiction of which the recipient is practising as a solicitor when he or she receives the money? The former alternative raises considerable legal and practical difficulties. For example, the legislation in the place of receipt may be confined to solicitors practising in that jurisdiction (or at least to those who are admitted there). Also, it may be unreasonable and unfair to expect solicitors to open trust accounts in another jurisdiction and comply with complex trust account rules if, for example, they do not practise in the jurisdiction rarely receive money in it and, when they do receive money there, usually transfer it without substantial delay to their "home" jurisdiction. Moreover, solicitors are less likely to be fully cognisant of the trust account rules in the place of receipt than those in the Jurisdiction in which they are practising.

4.14 In our Discussion Paper we suggested, in effect, that New South Wales trust account legislation should apply to any money entrusted to a solicitor in the course of practising as a New South Wales solicitor, whether or not the money was received inside New South Wales.[22] We added that if the money was received outside New South Wales and never brought into this State, the New South Wales legislation should apply, save for the current requirement that the money be paid into a bank in *New South Wales.* The Law Society of New South Wales responded that it had no objection in principle to these suggestions provided that" there is no conflict with the law of the place of receipt."[23] Under existing trust accounts legislation in the various Australian jurisdictions, it seems that no such conflict would arise from adoption of our suggestions. By contrast, some conflicts would arise if, for example, New South Wales sought to apply its legislation to all money received by solicitors in New South Wales, regardless of whether the money was received in the course of practising as a New South Wales solicitor.

4.15 **Recommendations: We recommend that the requirement for solicitors to pay money into a trust account in a bank should apply to any money received by a solicitor in the course of practising as a New South Wales solicitor, regardless of whether the money was received in New South Wales or elsewhere. Where the money is received outside New South Wales and never brought into this State, the requirement that the money be paid into a bank in New South Wales should not apply, but in all other respects the trust account requirements of this State should apply.**

4.16 We recognise that where a solicitor is entitled to practice in New South Wales and one or more other Jurisdictions, it may sometimes be difficult to determine whether particular money was received by him or her in the course of practising as a solicitor of this State or some other jurisdiction. This applies especially to solicitors having offices near the border between two States or who are members of one of the increasing number of firms which have off ices in more than one State.

4.17 In the absence of a national system of regulation of the legal profession, which we do not necessarily favour, we can see no comprehensive and convenient solution to these difficulties. **We recommend, however, that the Law Society of New South Wales should seek the co-operation of other law societies in developing**

specific guidelines for the handling of trust moneys received by solicitors who practise in more than one State and in making agreements as to which jurisdiction's rules are to be applied to a particular firm or a particular transaction. In order to give effect to such guidelines and agreements, the Law Society should be given power to direct that certain money which falls within the ambit of New South Wales trust account legislation should be dealt with in accordance with the legislation of another State.

Prompt Deposit

4.18 **Present Position:** Although solicitors in New South Wales are obliged to pay certain types of money into a trust account, there is no explicit time limit within which the payment must be made. However, a "Guide to Solicitors' Trust Accounts", produced by representatives of the Law Society and the two principal associations of accountants in New South Wales[24] states that

> "ordinary financial prudence indicates that trust moneys should be banked as soon as possible after they are received. This means, in practice, either on the day that they are received or the first banking day after receipt."[25]

4.19 **Discussion:** The system for regulating solicitors handling of trust money is weakened substantially if solicitors fall to pay the money promptly into a trust account. The risk of mishandling increases, and the likelihood of such mishandling being detected decreases. If prompt payment is to be expressly required by statute there are two possible approaches which could be adopted. One is to use a general expression requiring, for example, that payments must be made "forthwith" (as in Victoria),[26] "without delay" (as in England),[27] or " daily save where it is not reasonably practicable so to do" (as in Queensland).[28] The other is to fix a specific time limit such as "twenty four hours" excluding holidays (as in Tasmania)[29] or the end of the next banking day."[30] Specificity is obviously desirable in such an important requirement,[31] provided that the time limit is long enough to be reasonable and practicable but short enough to achieve its purpose. In our view, "the end of the next banking day" best meet these criteria.

4.20 **Recommendation: We recommend that where money is required to be deposited in a solicitors' trust account it should have to be deposited without delay and in any event not later than the end of the next banking day after the day on which it is received by the solicitor.**

C. Money which May, but *Need Not,* be Paid into a Trust Account

The Present Position

4.21 There is considerable uncertainty in New South Wales about the circumstances, if any, in which solicitors need not pay trust money into a trust account. The relevant statutory provision merely states that such money

> "shall be held by [the solicitor] exclusively for [the person for or on whose behalf it is received], to be paid to such person or to be disbursed as he directs, and until so paid or disbursed the moneys shall be paid into a bank in New South Wales to a trust account, whether general or separate."[32]

4.22 In practice, it is common for solicitors not to pay trust money into a trust account if, at or before the time of receipt, they are expressly or impliedly instructed by their client to do something else with it forthwith. For example, the client may direct that the money be paid to a designated person or that it be paid into a bank account in the client s name. However, if execution of the clients instructions is unlikely to occur within a day or so after receipt, the usual practice amongst solicitors is to pay the money into their trust account in the interim, unless the client expressly directs to the contrary. Indeed, failure to do so almost certainly would constitute a breach of the statutory requirement quoted in the previous paragraph.[33]

4.23 Before discussing the specific circumstances, if any, in which solicitors should be permitted not to pay trust money into a trust account, we refer to two general considerations. First, money which passes through a solicitors trust account attracts the Financial Institutions Duty on banking transactions which was introduced by the New South Wales Government in 1982.[34] This duty, which is currently at the rate of 3 cents per $100 (up to a maximum duty of $300), is payable on all deposits and withdrawals into a bank account, such as a solicitors trust account, but does not apply where money is paid without passing through such an account. There seems little doubt that the advent of this duty has increased the incidence of payments being made by methods other than through a solicitor s trust account.[35] These methods include payment directly between parties and payment via a solicitor but in such a form (for example, cash or an endorsed cheque) that it does not go through a trust account.

4.24 Secondly, an increased incidence of trust money passing through solicitors' hands but not through their trust accounts may have substantial implications for the Solicitors' Fidelity Fund and other beneficiaries of the interest earned on solicitors' trust accounts. in particular, although the Fidelity Fund bears potential liability for loss of such money through dishonesty on the part of the solicitor,[36] the money does not earn any interest which is available for allocation to the Fund.[37] In most cases, of course, the money is not in solicitors' hands for very long, but nevertheless the total interest "lost" by the Fund on all such transactions involving solicitors may be quite substantial.

Discussion

4.25 **Introduction:** The principal purpose of requiring trust money to be paid into a trust account before being disbursed is to ensure a degree of formality in the manner in which the money is handled and recorded. This formality increases the likelihood that the money will be handled properly and that the manner in which it is handled can be ascertained by others such as the client, another person in the practice, an outside accountant or auditor, or a Law Society inspector. On the other hand, there are circumstances in which the passing of money through a trust account can seem to both solicitor and client to be a cause of unnecessary delay, inconvenience and expense. It may be argued that in these circumstances solicitors should not be under an obligation to pay the money into their trust account, provided perhaps that they maintain adequate records of the manner in which they do handle the money.

4.26 In several other jurisdictions, the circumstances in which solicitors need not pay trust money into a trust account are expressly defined. For example, in England it is not necessary for a solicitor to pay into a trust account money

> "(a) which is received by him in the form of cash and is without delay paid in cash in the ordinary course of business to the client or on his behalf to a third party; or
>
> (b) which is received by him in the form of a cheque or draft which is endorsed over in the ordinary course of business to the client or on his behalf to a third party and is not passed by the solicitor through a bank account; or
>
> (c) which he pays into a separate bank account opened or to be opened in the name of the client or of some person designated by the client in writing or acknowledged by the solicitor to the client in writing."[38]

In addition, a solicitor must not pay into a trust account money

> "which the client for his own convenience requests the solicitor to withhold from such account, such request being either in writing from the client or acknowledged by the solicitor to the client in writing."[39]

4.27 These and other provisions[40] raise three broad categories for consideration as exemptions from the general requirement to pay trust money into a trust account. They relate to

> payment elsewhere in accordance with written instructions;
>
> payment elsewhere in the form in which the money is received (such as cask or an endorsed cheque); and
>
> payment to a bank account designated by the client.

We look at each of these categories in turn.

4.28 **Written Instructions:** As a general principle, clients' instructions about the way in which their trust money is to be handled should be paramount. On the other hand, those instructions may be expressed ambiguously, may be the subject of subsequent dispute, or may have been given without an adequate appreciation of their consequences. It is presumably for these reasons that, in South Australia, for example, the only exemption from the requirement to pay trust money into a trust account is where the client gives instructions in *writing* to handle the money in some other way.[41] Moreover, in some jurisdictions solicitors are specifically required to record details of their handling of trust money which is received by them but does not pass through their trust accounts. In South Australia, for example, prescribed details must be entered in a Direct Payments Register which is subject to independent scrutiny as part of the solicitor s trust account records.[42]

4.29 If payment in accordance with a clients instructions is to constitute an exemption from the requirement to pay trust money into a trust account, the question arises whether the money must not, or merely need not, be paid into the account. It seems that the answer should depend on the nature of the instructions. They may state clearly that the money must not be paid into the account or must be dealt with in some way which clearly precludes such payment. On the other hand, the instructions may direct that the money is to be handled in a certain manner, but may not preclude it being paid into the trust account pending execution of these instructions. In the latter situation there seems to be no good reason for prohibiting the solicitor from paying the money temporarily into the trust account if he or she so wishes. Indeed, consistently with views we have expressed earlier in this chapter there is good reason to *require* the solicitor to do so if the money remains in his or her hands beyond the next banking day after receipt.

4.30 The difference between the two types of instructions described in the previous paragraph may explain why in England the relevant legislation specifies that solicitors *"shall"*[43] not pay into a [trust] account" money which the client" requests [them] to withhold from such account",[44] but in South Australia it is *"lawful"*[45] for solicitors to "dispose of [trust moneys] in a manner specified" in a "written direction by the person entitled to them".[46] The English provision arguably applies only to the first of the two types of instruction which we have identified, where as the South Australian provision may have been drawn with the second type principally in mind.

4.31 **Payment in the Same Form:** In some Jurisdictions, Such as South Australia, the only exemption from the requirement to pay trust money into the trust account is where the client gives written instructions for the money to be handled in some other way.[47] In others, such as Victoria,[48] England[49] and Ontario,[50] an exemption applies where the money is passed on in the form in which it is received (that is, where cash is passed on as cash, or cheques or drafts are passed on by endorsement). This exemption may be restricted (as in England) to situations where the money is passed on "without delay [and] in the ordinary course of business,"[51] and in some Jurisdictions (such as Victoria[52] and Ontario[53]) the solicitor must record details of the transaction.

4.32 The case for an exemption of this kind rests principally on the alleged simplicity of the transactions in question the consequently low risk of mishandling or confusion, and the disproportionate degree of delay, expense and inconvenience which might arise from requiring passage through a trust account. On the other hand, there is considerable scope for mishandling or confusion in these transactions, at least if there is no specific limit on the time within which the money must be passed on or no adequate requirement that details of the transaction must be recorded and subjected to independent scrutiny in the same manner as trust account records. Moreover, as the Law Society of New South Wales has stated, expressions such as "without delay" or "in the ordinary course of business" may be insufficiently precise to prevent abuse.[54]

4.33 **Payment to Other Accounts:** We have referred earlier to the English exemption concerning payment to a bank account in the clients name or in the name of some other person designated by the client in writing.[55] Somewhat similar exemptions apply in Victoria[56] and Ontario,[57] subject to requirements concerning the recording of such transactions. It is difficult to identify any compelling reason for such an exemption. It lacks distinctive characteristics analogous to those which may be regarded as Justifying the two types of exemption discussed earlier. The Law Society of New South Wales[58] takes the view, in effect, that direct payment to another account should be permissible only if the client so instructs in writing and the instructions are accompanied by a prescribed form of acknowledgment by the client that he or she understands that the money otherwise would have had to be paid into the solicitors trust account. It may be doubted, however, whether requiring this form of acknowledgment would have significant utility.

Recommendations

4.34 In our view, the general requirement to pay trust money into a trust account is of great importance in reducing the risks of mishandling and disputation. Exemptions from that requirement should be limited to situations in which those risks are especially low and the inconvenience occasioned by the requirement may be substantial. Moreover, where an exemption applies, the manner in which the money is handled should have to be recorded, and be subject to independent scrutiny.

4.35 **Accordingly, we recommend that solicitors should not be required to pay trust money into a trust account provided that, not later than the end of the next banking day after its receipt, the money is disposed of by the solicitor**

> **in accordance with written instructions by the person for or on whose behalf it was received; or**
>
> **in the same form in which it was received and in accordance with instructions, whether written or oral, by the person for or on whose behalf it was received.**

Where there are express written instructions that the money is not to be paid into a trust account, the solicitor should not be permitted to pay it into such an account.

4.36 **We also recommend that where trust money is not paid into a trust account, details of the manner in which it has been dealt with should have to be recorded by the solicitor in a prescribed form of Direct Payments Register. The Register should constitute part of the solicitor's trust account records and be subject to independent scrutiny in the same manner as those records. Appropriate details should also be recorded in the trust receipt book and ledger.**[59]

4.37 Several aspects of these recommendations call for elaboration. First, in our view "trust money" includes cheques which clients make payable to a third party and then give to a solicitor for transmission to that party.[60] Our recommendations mean that such cheques would have to be recorded in the Direct Payments Register and, unless passed on as directed before the end of the next banking day, would have to be paid into the trust account if capable of being so paid.

4.38 Secondly, by "payment in the form in which it was received" we mean that

> in the case of payment in cash, the amount of cash paid must be the same as the amount of cash received; and
>
> in the case of payment by cheque or draft, payment must be effected by endorsement of the cheque or draft received.

4.39 Thirdly, we suggest that the Direct Payments Register should be required to indicate

the amount of money received;

when the money was received;

the name and address of the person for or on whose behalf the money was received;

whether the money was in cash, cheque or other form;

where the money was in cheque form the cheque number and the bank on which the cheque was drawn;

the name of the person from whom the money was received;

the manner in which it was received (for example, in person or by post);

the nature, and date of receipt, of any direction for payment made by the person for or on whose behalf the money was received;

the amount of money which was paid;

the name and address of the person to whom the money was paid;

the date on which the payment was made;

the form in which it was made (for example, cash, endorsed cheque, cheque): and

the manner in which the payment was delivered (for example, in person or by post).

These details are broadly similar to those which the Law Society of South Australia considers practitioners should include in Direct Payments Registers in that State.[61]

D. Money which *Must Not* be Paid into a Trust Account

The Present Position

4.40 There is no statutory provision in New South Wales which explicitly specifies types of money which must not be paid into a solicitors trust account. However, it is a widely held view that both at common law and by inference from a number of legislative provisions relating to solicitors trust accounts, solicitors must not pay into their trust accounts any money to which they are solely and absolutely entitled.[62] This does not preclude the common practice whereby a solicitor who receives a cheque which is partly his or her own money and partly money received on trust for others may pay the cheque into a trust account and then withdraw the amount to which he or she is personally entitled.

4.41 There has been considerable debate amongst lawyers in recent years about a related question, namely the propriety of retaining in a trust account money which was trust money when paid into that account but subsequently becomes the solicitor's own money. This arises especially where the money becomes due to the

solicitor for professional costs or disbursements, and we consider it in the next chapter when considering the general topic of costs and disbursements. In the present section we are concerned primarily with payment into trust accounts rather than retention in or withdrawal from, such accounts.

Discussion

4.42 There is a general principle of law that trustees must not mix their own money with money which they hold on trust.[63] The primary reason for this rule is to reduce the risk of deliberate or careless mishandling of the trust money occurring, and of any such mishandling as does occur going undetected or being exceedingly difficult to unravel.[64] The principal argument on the other hand, for allowing trustees to pay some of their own money into a trust account relates to the situation where a trustee receives a cheque which is partly his or her own money and partly trust money. In this situation it is convenient, and provides greater protection for the trust money, if the cheque is paid into the trust account and the trustee's own money is then withdrawn.

4.43 In several jurisdictions, there are explicit legislative provisions to the effect that, subject to specified exceptions, no money other than trust money may be paid into a solicitor's trust account. In England, for example, the exceptions permit payment into the trust account of

> money which is partly trust money and partly the solicitors own money;
>
> money which was incorrectly withdrawn from the trust account; and
>
> money necessary to open or maintain the account.[65]

The first and second of these exceptions apply also in Ontario, although the first of them is restricted to situations where "it is not practicable to split the payment" and is conditional on the solicitors' money then being withdrawn from the trust account "without delay".[66] In Queensland, the only exception relates to money which consists partly of professional costs or disbursements "already incurred or disbursed".[67] In South Australia, the general prohibition on payment of a solicitors money into his or her trust account is subject to the proviso "unless the Supreme Court otherwise approves."[68]

4.44 In our Discussion Paper we suggested adoption of provisions similar to those in Ontario, but we added, in effect, that the exception relating to payments comprising a mixture of trust money and the solicitor s own money should state that the latter money must then be withdrawn "within a prescribed time, say within the first three working days of the month following the receipt of the money."[69] The Law Society responded that solicitors should be entitled to pay their own money into a trust account. It said that, if properly kept, the trust account records will clearly indicate "the respective entitlements of I the solicitor and of each trust creditor.[70] This view was expressed before the basic principle that trust money should not be mixed with other money was given fresh emphasis by the court of Appeal in New South Wales in 1982.[71] The Law Society appears now to have accepted that solicitors Must Comply with that principle.[72]

4.45 In its response to our Discussion Paper, the Law Society also said that if solicitors were to be required to transfer their own money out of their trust account, the time limit for doing so should "be no more strict than that

the transfer be made without unreasonable delay".[73] They opposed a fixed time limit, "particularly in cases of sole practitioners and small practices, as pressing day-to-day demands of clients' urgent business or the practitioner being on vacation or away at seminars or in court, may well have to take priority over a solicitor attending to seeing himself paid.[74] This objection seems to relate principally to transfers concerning professional costs and disbursements.

Recommendation

4.46 In our view, the general principle that trust money should not be mixed with other money is sound and is of great importance in the context of solicitors' trust accounts. That rule, and any permissible exceptions to it, should be clearly stated in legislative form. One substantial exception which we regard as Justifiable relates to money which is partly trust money and partly other money. As we have mentioned,[75] a similar view has been taken in several Jurisdictions where specific legislative provisions on this topic have been made.

4.47 Where the solicitor s own money is paid into a trust account pursuant to the exception mentioned in the previous paragraph it should not be allowed to remain there for a lengthy period. A requirement to withdraw it "without delay" is, in our view, too vague to be useful. On the other hand, any fixed time limit should not be so short as to place unreasonable burdens on solicitors, and must take into account the time needed to ascertain precisely how much of the money belongs to the solicitor. Special difficulties may arise in relation to ascertainment of costs and disbursements, but these could be dealt with by a special rule and are considered in the next chapter.

4.48 Another Justifiable exception arises from the uncertainty which may arise in some circumstances about whether particular money constitutes trust money within the meaning of the legislation. This may occur, for example, where the money is received in another Jurisdiction,[76] or in a capacity other than that of a solicitor.[77] Solicitors ought not to be deterred, let alone prohibited, from paying into their trust account money which they believe, on reasonable grounds, may constitute trust money.

4.49 Accordingly, **we recommend specific legislation to the effect that money must not be paid into a solicitor's trust account unless it is**

trust money;

money which is partly trust money and partly the solicitor's own money, provided that the latter is then withdrawn from the trust account within one month;

money which the solicitor considers on reasonable grounds is, or may be, trust money;

money incorrectly withdrawn from the account; or

money necessary to open or maintain the account.

4.50 Where a solicitor receives money in relation to professional costs or disbursements, difficulties may arise in determining when the money becomes the solicitors own money in the sense referred to above. This issue is discussed in the next chapter.

III. WITHDRAWING MONEY FROM TRUST ACCOUNTS

A. Introduction

4.5 1 In this section we consider three issues concerning withdrawals from trust accounts. They are:

should solicitors be required to obtain written instructions before withdrawing a client's money from their trust account?

should there be restrictions on the forms in which payments from trust accounts may be made?

what should be the effect on a solicitor s trust account of a garnishee order against the solicitor?

A number of other issues concerning withdrawals from trust accounts arise in the context of costs and disbursements and are discussed in chapter 5.

B. Written Instructions

The Present Position

4.52 We have discussed the question of instructions concerning trust money which has not yet been paid into a trust account.[78] We are concerned here with withdrawal of money after it has been paid into the account. In New South Wales, such withdrawals can be made for only two purposes, namely to pay the person for or on whose behalf the solicitor received the money or to make such other payment "as [that person] directs".[79] There is no requirement that such direction be in writing, nor that it be express rather than implied.

Discussion

4.53 It is by no means uncommon for disputes to arise about whether a particular withdrawal was made in accordance with the relevant client's instructions. The dispute may be whether any relevant instructions were given or about the precise terms of the instructions. The latter type of dispute has arisen on many occasions in recent years over the nature of investments made by solicitors on their clients' behalf For example, clients have

asserted that they instructed that the investment be secured in a certain way, or be made at not less than a specified rate of interest.[80]

4.54 Disputes of the kind to which we have referred can cause considerable harm to both solicitors and clients. Moreover, uncertainty about the terms of clients' instructions in substantially increase the difficulty, time and expense involved in inspecting or auditing solicitors' trust accounts. Where a defalcation occurs, the Management Committee of the Solicitors' Fidelity Fund may find it exceedingly difficult if not impossible, to ascertain whether the solicitor acted dishonestly (in which case the Fund may be liable) and how much pecuniary loss has been incurred.[81] For example, the amount of loss incurred through an unauthorised investment may depend on whether the client is telling the truth in claiming that the solicitor was instructed not to invest without a certain amount of security or at an interest rate below a certain percentage. The Management Committee has had to grapple with many issues of this kind in recent years, often involving large sums of money.[82]

4.55 These considerations suggest that it might be desirable to require that no withdrawals be made from a trust account save in accordance with written instructions by the person for or on whose behalf the money was received. On the other hand, a general requirement of this kind could cause considerable inconvenience in many instances. One of the most common reasons for putting money in a solicitor s trust account is to facilitate simple and speedy payments by the solicitor as and when they become appropriate.

4.56 Moreover, if written instructions were required in all instances, many solicitors might obtain general instructions from their clients giving "blanket" authorisation for payments of such kind, and at such time, as the solicitor considers appropriate. Indeed, general instructions of this kind would be almost essential in many instances. For example, if a client pursuing litigation provides a sum of money in advance to meet the various disbursements which will be made by his or her solicitor in the course of the case, it would be extremely burdensome if separate written instructions had to be given for each disbursement Yet a requirement that all withdrawals must be authorised in writing would provide little protection for clients if solicitors responded by obtaining blanket written authorisations as a matter of course.

4.57 We know of no jurisdiction in which all withdrawals Must be in accordance with a written instruction. Some, however, require written instructions for certain types of withdrawals. In Queensland, for example, all withdrawals "for the purpose of the investment howsoever of the money withdrawn must be authorised in writing in advance, save where the withdrawals "for the purposes of paying for any land, chattels or livestock for the purchase in the name of the client of which the moneys in question were paid into the trust account."[83] In some jurisdictions, written Instructions must be obtained in certain circumstances where the withdrawal is to pay the solicitor's costs and disbursements, this particular issue is considered in the next chapter.

4.58 In our Discussion Paper we suggested that there should not be a general requirement that withdrawals be made only in accordance with written instructions.[84] One of us, however, suggested that withdrawals for the purposes of investment should have to be authorised ill writing in advance.[85] The Law Society of New South Wales responded by agreeing that there should be no general requirement, but proposed that written instructions should be required for a wide range of withdrawals for the purposes of investment,[86] and for payments into a trust account other than at a bank. The Society agreed with our suggestion that a general requirement would "interfere seriously with the ordinary business of solicitors".[87] The Society said, however, that its "policy is to encourage solicitors to consider in every case whether it is desirable for any reason to seek written instructions, or alternatively to confirm oral instructions, for disposition of trust money."[88]

4.59 Other responses to our Discussion Paper agreed that there should be no general requirement but some, including the New South Wales Auditor-General,[89] agreed with the Suggestion by one of us that written directions should be required ill relation to investments.

Recommendation

4.60 We believe that a general requirement for written directions would be unduly onerous for solicitors and clients in many circumstances. However, we consider that there should be such a requirement, in relation to withdrawals for the purposes of investment. We make a recommendation to that effect in chapter 11, which is concerned with the general topic of investment of client's money.[90]

4.61 **Accordingly, we recommend that, generally speaking, solicitors should not be required to obtain written authorisation in advance before withdrawing money from trust accounts.**

C. Forms of Payment

The Present Position

4.62 There is no restriction on the form in which money may be withdrawn from a solicitors trust account Thus, for example, withdrawals can be made by cheque payable to the bearer.

Discussion

4.63 The Commonwealth Bills of Exchange Act 1909 provides that if a cheque is unendorsed and payable to order, there is a rebuttable presumption that the money was received by the payee.[91] If the cheque is in some other form, however, there is no such presumption and the drawer has the burden of proving receipt by the payee, if any, named on the cheque. This distinction, for which there are obvious justifications, presumably reflects a belief that cheques made payable to a particular person are substantially more likely to transfer money to that person if they are payable to order. it may be argued, however, that many solicitors and clients would be inconvenienced on occasion by a requirement that withdrawals from trust accounts must be made only by cheques payable to order.

4.64 In some jurisdictions there is no restriction on the form in which money may be withdrawn from trust accounts. In Queensland, however, withdrawals must be made by the solicitor s cheque, or a bank cheque, which is "crossed and marked on its face 'not negotiable' and payable to order."[92] In South Australia, they must be made by cheques which are "crossed either generally or specially and marked 'not negotiable"', or are "endorsed by the recipient before being handed to him by the practitioner."[93] In Ontario, cheques drawn on a trust account must not be "made payable either to cash or to bearer."[94]

4.65 In our Discussion Paper, we said that we were not presently inclined to suggest any change to the position in New South Wales in this respect.[95] The Law Society made no response to this view, but it may be reasonable to assume that it agreed with it.

Recommendation

4.66 We have referred earlier in this Report to the extremely high level of trust account defalcations in New South Wales both in absolute terms and by comparison with other jurisdictions.[96] Despite the Law Society's predictions to the contrary, the position has not improved in recent years. We, now consider that the forms in which payment may be made from trust accounts ought to be restricted in such a way as to reduce the possibility of payments being made improperly or in a form which is not readily traceable. We note that substantial restrictions of this kind have been adopted in several Jurisdictions which in many respects are comparable to New South Wales except that their levels of defalcation are not as serious as in this State. Accordingly **we recommend that all payments from trust accounts should have to be made by crossed cheques which are marked "not negotiable" and payable to order.**

D. Garnishee Orders against Solicitors

The Present Position

4.67 Trust moneys received by solicitors are, by virtue of the Legal Practitioners Act, 1898,

> "not available for the payment of the debts of the solicitor to any other creditor of the solicitor, [nor] liable to be attached or taken in execution under the order or process of any Court at the instance of any such creditor."[97]

However, as this Commission pointed out in a Report in 1966,[98] if a garnishee order is issued by a creditor attaching the moneys of a solicitor held to the credit of his or her account with a bank, the bank is required, under existing legislation to freeze all accounts of the solicitor, including any account which may be a trust account. This is because it remains for the court to determine whether or not all moneys in the account are, in fact, trust moneys.

4.68 People who have money in the trust account of a solicitor maybe prejudiced if money in that account becomes the subject of garnishee proceedings out of a judgement debt of the solicitor. They can be denied access to their money pending the determination of its ownership by a Court. However, officers of the Supreme Court and the District Court have informed us that this problem seldom occurs in practice and that, where it does occur, the solicitor's affairs are usually in such a sorry condition that the problem can be resolved quickly by the appointment of a receiver of the solicitor s property.[99] The receiver is entitled by statute to withdraw money from the solicitor's trust account, pay it into an account in his or her own name, and operate on that account.[100] Of

course, there may be circumstances in which this course of action is inappropriate where, for example, there is genuine doubt about whether all of the money in the account is trust money rather than the solicitor s own money.

Discussion

4.69 There are obviously strong arguments against depriving a judgement creditor of access to any of the solicitor's own money which may be in the trust account. However, in assessing the practical significance of this issue it must be borne in mind that, as mentioned earlier, the Court of Appeal in New South Wales recently re-affirmed the basic principle that solicitors should not keep their own money in their trust account, and the Law Society has brought this decision to the attention of its members.[101] Moreover, we make recommendations elsewhere in this Report which, if adopted, would reduce the likelihood of substantial sums of solicitors' money being paid into, or retained in, their trust accounts.[102]

4.70 In many other jurisdictions the position concerning garnishee orders and solicitors trust accounts is broadly similar to New South Wales. In England and Ontario, however, clients' money in solicitors' trust accounts has no statutory protection from garnishee orders against solicitors. Nevertheless, it is arguable that protection is afforded by the general law relating to such orders.

4.71 In Queensland, the statutory protection is wider than in New South Wales, since it applies to all moneys held in the trust account irrespective of whether they are trust money or the solicitor s own money.[103] But, as we have mentioned earlier, there is a general statutory prohibition in Queensland against paying money other than trust money into a trust account.[104]

4.72 In our Discussion Paper we suggested that one possible approach is to provide that solicitors' trust accounts are liable to garnishee orders against solicitors only by a special procedure under which the judgment creditor has an onus of showing what money in the account is the solicitor's money rather than his or her clients' money.[105] This approach would need to be supplemented by a requirement that solicitors' trust accounts be designated in a prescribed way, such as "The Solicitors' Statutory Trust Account of (X)".

Conclusion

4.73 Garnishment proceedings are part of the general law relating to enforcement of money judgments. Moreover, the problems which may be experienced with garnishee orders against solicitors in relation to solicitors' trust accounts are similar to those which arise with garnishment in other contexts. Accordingly, we do not consider that it is appropriate to deal with the problems referred to in earlier paragraphs other than in the context of a general review of garnishment and enforcement of money judgments. We are reinforced in this view by the lack of evidence of substantial difficulties having occurred in practice in relation to the effect on solicitors trust accounts, of garnishee orders against solicitors.

FOOTNOTES

1. See, esp., Legal Practitioners Act, 1898, ss.41-44, and Solicitors Trust Account Regulations.

2. See, esp., Trust Accounts Act 197 3, ss.4, 7,8,12 and Trust Accounts Regulations 197 3, reg.5.

3. See, esp., Solicitors' Accounts Rules 1975.

4. See. esp., Law Society Regulations, reg.18.

5. See, esp., Law Practitioners Act 1982, s.89; Solicitors Audit Regulations 1969, regs.34,35; and Solicitors Trust Account Rules 1969.

6. See, esp., Rules of Practice 1977. rr.20,22.

7. See Law Society Regulations, reg.18(4)-(6)).

8. Legal Practitioners Act, 1898, s.41(2).

9. *Id*., s.56(1).

10. See Certificate of Insurance, cl. 1(b), published in New South Wales Government Gazette, No.57, p.1634 (8th April 1983).

11. See our Discussion Paper, paras.4.12-4.14, and Baker v. Law Institute of Victoria [1974] V.P, 388.

12. Cf., Solicitors (Audit and Practising Certificates) Rules, 1965, r.2(1) (Victoria). See also the relevant Fidelity Fund provision in New South Wales (para.4.5 above).

13. Cf., Legal Practitioners Ordinance (A.C.T.) 1970, s.46(1).

14. Cf., Solicitors' Accounts Rules, 1975, r.2(1) (England). Note the special rules in England relating to "solicitor-trustees" Solicitors' Trust Account Rules, 1975. See also the Master Policy for the professional indemnity insurance scheme in New South Wales (para.4.5 above).

15. Discussion Paper, paras.4.10-4.20.

16. Law Society's Response, para.2.1.

17. See paras.4.28-4.30 and 4.35 below.

18. See Legal Practitioners Act, 1898, s.56(1).

19. See current Certificate of Insurance, cl. 1(b).

20. See chapter 11.

21. Legal Practitioners Act, s.41 (1).

22. Discussion Paper, paras.4.21-4.25.

23. Law Society's Response, para.2.4.

24. The Australian Society of Accountants and the Institute of Chartered Accountants.

25. "Guide to Solicitors' Trust Accounts" (1980), p. 3.

26. Legal Profession Practice Act 1958, s.40(1)(a).

27. Solicitors' Accounts Rules 1975, rule 3.

28. Trust Accounts Act 1973, s.7(3).

29. Rules of Practice 1977, r.20(1) (b), (2).

30. See, e.g., note 4.18.1 above; Travel Agents Act, 1973 (N.S.W.), s.42B(3); Solicitors Trust Account Rules 1969 (New Zealand), r.4.

31. The Law Society of New South Wales has described expressions such as "without delay" as being "capable of abuse" (Law Society's Response, para.2.8).

32. Legal Practitioners Act, 1898, s.41 (1).

33. See also note 4.18.1 above.

34. See Stamp Duties Act, 1920, Division 29 and Second Schedule.

35. See, e.g., Law Society of New South Wales, " Important Circular to Members: Stamp Duties (Financial Institutions Duty) Amendment Act 1982" (published in the Society's newsletter, Caveat (19 January 1983)).

36. Legal Practitioners Act 1898, s.56.

37. Accumulation and allocation of this interest is described in paras.2.5-2.7 above.

38. Solicitors' Accounts Rules, 1975, r.9(1).

39. *Id*., rule 9(2) (a).

40. E.g., Legal Practitioners Act 1981 (S.A.), s.3 1(2); Solicitors (Audit and Practising Certificates) Rules 1965 (Vic.), r.24; Law Society Regulations (Ontario), reg. 18(5).

41. Legal Practitioners Act 198 1, s.3 1(2).

42. *Id*., s.31(2) and (5) and Law Society of South Australia, Legal Practitioners Trust Accounts Manual, pp.15,18-19. See also Law Society Regulations (Ontario), reg.18(5); Solicitors (Audit and Practising Certificates) Rules 1965 (Vic.), r.24.

43. Our emphasis added.

44. Solicitors' Accounts Rules, 1975, r.9(2)(a).

45. Our emphasis added.

46. Legal Practitioners Act 198 1, s.31(2).

47. *Ibid.*

48. Solicitors (Audit and Practising Certificates) Rules 1965, r.24(1).

49. Solicitors Account Rules 1975, r.9(1)(a) and (b). See para.4.26 above.

50. Law Society Regulations, reg. 18(5).

51. See note 4.31.3. above. In Ontario payment Must be made "forth with" and "in the ordinary course of business": Law Society Regulations, reg. 18(5)(c).

52. See note 4.31.2 above.

53. See note 4.31.4 above.

54 .Law Society's Response, para.2.8.

55. See para.4.26 above.

56. Solicitors (Audit and Practising Certificates) Rules 1965, r.24(2) and (3).

57. Law Society Regulations, reg.18(5)(b).

58. Law Society's Response. para.2.8.

59. See, e.g. Law Society of South Australia, *Legal Practitioners Trust Accounts Manual,* p. 19.

60. See, e.g., Law Society of South Australia, *Legal Practitioners Trust Accounts Manual,* p.2. On the issues dealt with in this paragraph, see also Solicitors (Audit and Practising Certificates) Rules 1965 (Vic.), r.24(1)(b)(ii): Solicitors' Account Rules, 1975 (England), r.9(1)(b).

61. *Id.,* p.18. See also the Law Institute of Victoria's "Rule 24 Book" which is a suggested form for a Direct Payments Register.

62. See, eg. Johns v. Law Society of N.SW, [1982] 2 N.S.W. L.R.1, esp. at p.20, per Hope J.A. (also Moffitt P. At pp.17-18); R.P. Meagher and W.M.C. Gummow, Jacobs' Law of Trusts in Australia (4th ed, Butterworths, Sydney, 1977), p.317. 4.42 1. Ibid.

63. *Ibid*.

64. *Ibid.*

65. Solicitors' Accounts Rules, 1975, r.4.

66. Law Society Regulations, reg. 18(4) and (6).

67. Trust Accounts Act 1971, s.7(2).

68. Legal Practitioners Act 1981, s.31(6). There is a specific exception in relation to costs and disbursements but it does not cover payment into, as distinct from retention in, a trust account (Legal Practitioners Regulations 1982, reg.19).

69. Discussion Paper, para 4.5 1.

70. Law Society's Response, para 2.9.

71. See note 4.40.1 above.

72. "Special Bulletin to All Members: Statement on Trust Account Treatment of Costs and Disbursements", 28 March 1983.

73. Law Society's Response, para.2.9(d).

74. *Id*., para.2.9(c).

75. See para.4.43 above.

76. See paras.4.12-4.17 above.

77. See paras.4.5-4.11 above.

78. See paras.4.28-4.30,4.34-4.39 above.

79. Legal Practitioners Act, 1898, s.41(1).

80. See eg, the Solicitors' Statutory Committee cases of Florance, Butler, Miller and Bridges (No.1 of 1982), Cummins (No.4 of 1982) and Roper (1981) 20 Law Society Journal 20.

81. For the scope of the Fund's liability, see Legal Practitioners Act, 1898, esp.s.56.

82. See note 4.53.1 above.

83. Trust Accounts Act 1973, s.8(2).

84. Discussion Paper, para.4.57.

85. *Ibid.*

86. See paras.11.16 below, and draft Solicitors Trust Account Regulations, reg.14, in Appendix III of this Report.

87. Law Society's Response, para.2.10.

88. *Ibid.*

89. See para. 11.16 below.

90. See paras. 11.12-11.17 below.

91. s.88C.

92 .Trust Accounts Act 197 3, s.12(1).

93. Legal Practitioners Regulations 1982, reg.22.

94. Law Society Regulations, reg.18(10).

95. Discussion paper, para.4.78.

96. See chapter 2.

97. s.41(2).

98. *Report on Proposed Amendments to the Legal Practitioners Act,* 1898-1960 (L.R.C. 2), p 9.

99 .Legal Practitioners Act 1898, s.65 B.

100. *Id*., s.65F(4).

101. See para.4.44 above.

102. See paras.4.49 above, and 5.46 and 5.52 below.

103. Trust Accounts Act 1973, s.10.

104. *Id.,* s.7(2).

105. Discussion Paper, para.4.102.

5. Handling Trust Money: Issues Relating to Costs and Disbursements

I. INTRODUCTION

5.1 In this chapter we look first at the present position in New South Wales concerning the handling of money paid to solicitors for or on account of costs and disbursements. We do so under three headings, namely

payment into a trust account;

withdrawal from a trust account;

refusal to withdraw from a trust account.

We then discuss difficulties which arise in each of these areas, and various possibilities for reform. We conclude the chapter with our recommendations.

II. THE PRESENT POSITION

A. Payment into a Trust Account

5.2 The statutory requirement to pay trust money into a trust account is expressly excluded in relation to "moneys receivable by a solicitor for or on account of legal costs, whether already due or to accrue due."[1] There is considerable uncertainty about the meaning and scope of this exclusion. For example, it is not clear whether "costs" includes "disbursements", nor whether it relates to all costs or, say, only those where the work has already been performed and a bill rendered to the client.[2] Moreover, confusion or dispute may arise over whether particular moneys paid to a solicitor were "receivable for or on account of legal costs" rather than having been paid for some other purpose or for general purposes.[3]

5.3 The effect of this exclusion is that money falling within its ambit need not be paid into a trust account. In some circumstances, however, such money must not be paid into a trust account. This arises from the general principle to which we referred in the previous chapter[4] that trustees must not mix their own money with trust money. If a solicitor performs work, renders a bill and then receives payment of the amount shown in that bill the money is received as his or her own money and therefore must not be paid into the trust account(unless it is received as part of a payment which also includes trust money[5]). The position is less clear, however, where the money is received after the work has been done but before a bill has been rendered. In this situation it may be permissible

for the money to be treated as trust money, rather than as the solicitor s money, and paid into the trust account. Indeed, it may be mandatory to adopt this procedure in such circumstances.

5.4 It is not surprising, given the uncertainty of law, that there is no uniform practice amongst solicitors in New South Wales concerning payment into the trust account of moneys received for or on account of professional costs and disbursements. In relation to money received for or on account of *costs,* if the work has been done and a bill rendered before the money is received by the client, most solicitors would pay the money directly into their general account rather than their trust account. If the work has been done but no bill rendered, some solicitors would pay the money directly into their general account, but others would pay it into their trust account at least until a bill has been rendered. If the work has not yet been carried out, most solicitors would pay the money into their trust account, save perhaps where the work is to be completed in the very near future. In relation to money received for or on account *of disbursements,* most solicitors usually would pay the money straight into their general account if the disbursements have already been made or are about to be made, especially if the amount involved is substantial, but otherwise would pay it into their trust account.

B. Withdrawal from a Trust Account

Entitlement to Withdraw

5.5 There is also some controversy about the law relating to withdrawals from trust accounts in relation to costs and disbursements. The first issue concerns the circumstances under which solicitors may make such withdrawals. Prior to 1976, it was generally considered amongst solicitors in New South Wales that they were entitled to withdraw trust money held on behalf of a client in order to pay costs earned by them, and disbursements made by them on behalf of that client, irrespective of whether the client had instructed them to make such a withdrawal. In the light of a Supreme Court decision in that year,[6] however, it now appears that withdrawals may be made in two situations only, namely where

the client has given clear instructions to that effect; or

the solicitor has what is known as a “particular lien”, and has obtained a court order entitling him or her to withdraw the money.[7]

A particular lien applies only to such money, if any, as the solicitor has obtained for the client by means of litigation or arbitration and has paid into his or her trust account. The lien can be used by the solicitor to obtain a court order permitting withdrawal from that money to meet such costs and disbursements as were earned or made in the course of conducting the particular litigation or arbitration in question but not other amounts to which the solicitor may claim to be entitled.[8]

5.6 Until 1976 it was not uncommon for solicitors to pay their costs and disbursements from trust money without obtaining the clients instructions to do so. We understand, however, that the profession at large now accepts that this practice is unlawful and that prior instructions must be obtained. But there is room for doubt about whether, in fact, clients’ express instructions are always obtained; great and perhaps unjustified, reliance may sometimes be placed on what a solicitor alleges is implied acquiescence by a client. Many solicitors usually render a bill when

seeking a clients instructions to pay themselves from trust money, or, if they already have such instructions, they may render a bill upon or before implementation of those instructions. Bills are less likely to be rendered in relatively simple matters or where a fee has been agreed in advance.

Requirement to Withdraw

5.7 The second issue concerns the circumstances in which solicitors must make withdrawals from their trust account in relation to costs and disbursements. After much uncertainty and debate, the current law in New South Wales has been described authoritatively by the Court of Appeal as follows:

> "If a solicitor is entitled, on his client's behalf, to pay and, on his own behalf, to receive money of the client in the solicitor s trust account to meet costs owing by the client to the solicitor, the proper course is to separate what is to become the solicitor s money from trust moneys, by a withdrawal of the money from the trust account and by payment of the cheque to the solicitors general account."[9]

It is not permissible, the Court said, for the money merely to be transferred within the trust account from a ledger account in the client s name to one in the solicitors name.[10] We assume that the term "costs", as used by the Court of Appeal in this context included "disbursements".

5.8 Despite this recent clarification some major questions remain unresolved. The most important one is: when does a solicitor become, in the words of the Court of Appeal, "entitled to receive money for his or her costs or disbursements?[11] It may be argued that the entitlement arises when the work is done or the disbursement made, subject to the general rule that, in the absence of agreement to the contrary, no money for professional costs is payable by a client to his or her solicitor until the whole task is completed.[12] Alternatively, it may be argued that no entitlement arises until the solicitor not only carries out the work, or makes the disbursement, but also renders a bill.[13] A third possibility is that entitlement does not arise until one month after a detailed bill has been rendered. This possibility arises from the existence of a statutory prohibition against solicitors suing for their costs until one month after they have delivered a detailed bill to their client.[14]

5.9 A second unresolved question is how quickly solicitors must pay themselves from their trust accounts upon becoming entitled to do so. Must they, for example, do so "forthwith", or within a day or a month?

5.10 It seems clear that solicitors are under no general obligation to take prompt action upon completing work for a client, to render a bill and/or seek instructions to pay themselves from any trust money which they may hold for or on behalf of the client. Accordingly, sums of money which a solicitor has earned, and would be entitled to withdraw if he or she completed the requisite formalities, may remain in the trust account for substantial periods. In other words, a trust account may contain considerable sums of money to which, in a loose colloquial sense, the solicitor is entitled although in a legal sense they remain on trust for the client.

5.11 Following the Court of Appeal decision in 1982, the Law Society advised its members that they must discontinue the hitherto widespread practice of transferring money, said to be due from a client for costs and

disbursements, from a trust ledger in the clients name to one in their own name. It is not known whether this directive has been implemented by all solicitors. In the Court of Appeal reference was made to a

> "suggestion that whilst a solicitor may not yet have acquired an entitlement in respect of the trust bank account moneys or an entitlement to be paid a particular amount (because, for example, he had not complied with all of the precedent formalities in that regard), yet he may set up in the trust account records an account of the amounts which subject to compliance with such formalities, he will be entitled to have. Such an account would be generally of the nature of a control account, recording amounts which by a proper appropriation, will become his".[15]

One member of the Court indicated that he regarded such control accounts as lawful.[16] The Law Society has taken the view that it is permissible to use a "Costs and Disbursements Clearing Account in the trust ledger for the purpose of transferring costs and disbursements from the trust account to the general account, provided that money passes straight through the clearing account and it has a "nil balance" at the end of each day.

C. Refusal to Withdraw from a Trust Account

5.12 We have referred earlier to the "particular lien" which in certain circumstances enables solicitors to obtain a court order under which they may pay themselves from a clients trust money even though the client does not wish them to do so.[17] Where this lien applies, it also entitles solicitors to refuse to pay the money out of their trust account despite their client's instructions that they must do so.

5.13 At common law, solicitors also have what is called a "general lien" over money in their possession.[18] One effect of this lien is that, until a client has paid his or her costs or disbursements, the solicitor is entitled to retain money in their possession which otherwise would be payable to the client. The general lien does not entitle solicitors to do more than retain money, unlike the situation where they have a particular lien, they cannot pay it to themselves. It is arguable, however, that the general lien does not apply to trust moneys and, if it does, has been overridden in that respect by statute in a number of jurisdictions, including New South Wales.[19]

5.14 But even if they do not have a general lien over trust money, solicitors may be entitled, in effect, to deduct money which a client owes to them for costs and disbursements from any trust money which they may owe to that client. This right of "set-off" exists at common law and may not have been overridden by statute in New South Wales.[20]

III. DISCUSSION

A. Payment into a Trust Account

Future Work or Disbursements

5.15 It is difficult to see any good reason why solicitors should not be required, generally speaking, to pay into a trust account any money received on account of costs for work which they have not yet performed or disbursements which they have not yet made. We know of no jurisdiction other than New South Wales in which solicitors are not subject to such a requirement We suggested in our Discussion Paper that a general requirement of this kind should be introduced,[21] and the Law Society has expressed its agreement with that suggestion.[22]

5.16 There are two possible exceptions to such a requirement which merit particular consideration. The first is where the client instructs the solicitor to deal with the money in some way other than paying into the trust account. This may occur, for example, where a matter is likely to be protracted and the client agrees to make part-payment in advance rather than expect the solicitor to go without any payment until the matter has been completed. The Law Society considers that an exception should apply where solicitor and client make an arrangement that the money should not be paid into the trust account.[23] In several other jurisdictions, including England[24] and Ontario,[25] such an arrangement must be in writing signed by the client. The principal justification for requiring written instructions is to reduce the possibility of confusion or dispute arising, not only about whether the alleged instructions were actually given but also about the services and disbursements intended to be covered by the payment. The latter concern suggests that it may be appropriate to require the solicitor, immediately upon receipt of the money, to render a bill or receipt which identifies the services, as yet unperformed, for which the money is being paid. A requirement of this kind applies in British Columbia.[26]

5.17 The second possible exception concerns the situation where the work is to be performed, or the disbursement made, very shortly after the client pays the money. For example, when solicitors appear in a Court of Petty Sessions for a client, it is not uncommon for them to be paid in full, often at their request, a day or even only a few minutes before the hearing. It may be argued that in these circumstances it is unduly officious to require the money to go through a trust account. On the other hand, we have recommended earlier[27] that money need not be paid into a trust account until the end of the next banking day. If the work has been performed by that time, the money can be handled on that basis rather than as payment for work not yet done. The same would apply to disbursements made before the end of the next banking day. Moreover, any inconvenience can readily be avoided by obtaining the clients written instructions not to pay the money into the trust account.

Past Work or Disbursements

5.18 There is no dispute, so far as we are aware, that where solicitors receive money for work which they have performed, or disbursements which they have made, they should not have to pay the money into a trust account if they have written instructions from their client to handle it in some other way. Indeed, if the instructions require, rather than merely permit, the money to be handled in this other way, the solicitor must comply with them.

5.19 A more difficult question is whether, in the absence of written instructions, solicitors should have to pay the money into a trust account unless some form of bill for the relevant costs or disbursements has been rendered. The main justification for such a requirement is to provide written evidence for all concerned, including those responsible for examining the solicitors accounts, of the purpose for which the payment was made and the reason why it did not go into the trust account. Of course, a bill is unlikely to be of much assistance in this regard unless it gives some particulars of the work performed and the disbursements made, and indicates the period during which these events occurred.

5.20 The principal argument against requiring a bill to be rendered is the work and delay which it may involve. But the work and delay need not be substantial if it is accepted that the bill need not particularise the services in detail approaching that of a bill of costs suitable for taxation. Moreover, the requirement to prepare a bill would help to ensure that solicitors carefully what services they are charging for, and what are the appropriate charges for those services, before deciding upon a total sum to be sought from the client.

5.21 There may be a case for distinguishing between costs and disbursements in this context. It would be unreasonable to require a solicitor to remain for a lengthy time without reimbursement of a substantial out-of-pocket expense on behalf of a client. On the other hand, if the need to recoup a substantial disbursement, or a series of disbursements, became of substantial concern to the solicitor, he or she could solve it by rendering a bill and obtaining payment Moreover, the need for accountability and for accurate records is no less significant in relation to disbursements than in relation to costs.

5.22 The only specific provisions about withdrawals for past work or disbursements in the other jurisdictions to which we have referred are those in England and Ontario. In each case the provisions refer to money which *must not* be paid into a trust account In England, this requirement applies to money which is paid to the solicitor

> in reimbursement of money expended by the solicitor on behalf of the client; or which is expressly paid to [the solicitor] either -
>
> (i) on account of costs incurred in respect of which a bill of costs or other written intimation of the amount of the costs incurred has been delivered for payment; or
>
> (ii) as an agreed fee ... for business undertaken."[28]

In Ontario, the requirement applies to money

> "that is received by the [solicitor]... for services already performed for which a billing is delivered forthwith thereafter or is received to reimburse the [solicitor] for disbursements made or expenses Incurred on behalf of the client."[29]

5.23 In our Discussion Paper we suggested, in effect, that money received for past work should have to be paid into a trust account unless and until a bill, not necessarily in detailed form has been rendered.[30] The Law Society responded that the money should have to be paid into a trust account unless there is an "arrangement to the contrary" or the money is "capable of being applied against either a bill already rendered or disbursements already paid.[31]

Direct Payments Register

5.24 We have recommended earlier that money which is received by a solicitor on trust but is not paid into a trust account should be recorded in a Direct Payments Register.[32] There would be obvious advantages in requiring that any money received for or on account of costs or disbursements, but not paid into a trust account, should also have to be recorded in that Register. In many instances the nature and propriety of certain payments into, or withdrawals from a trust account in relation to a particular client cannot be established without knowing details of any payments by the client for costs or disbursements which have not passed through the trust account.

B. Withdrawal from a Trust Account

5.25 As we explained earlier the present position in New South Wales is that solicitors must not withdraw money from their trust accounts for costs or disbursements unless either they have clear instructions from their client to do so, or they obtain a court order for withdrawal because they have a particular lien over the money in question. Two principal areas arise for consideration of possible reforms, and we look at each of them in turn below.

Upon Client's Instructions

5.26 First, should the client's instructions to withdraw costs and disbursements provide sufficient justification in themselves for making such a withdrawal? The main arguments in favour of this approach are the general desirability of giving paramountcy to clients' wishes, and the fact that in some circumstances it may be of great importance to clients that they be entitled to give advance authorisation for a withdrawal. There are situations, especially where major disbursements may be necessary at short notice, in which it would be quite reasonable for solicitors to insist on such authorisation as a condition of being willing to undertake the clients work.

5.27 On the other hand, there is considerable scope for uncertainty and argument about whether instructions were given, or in what terms they were given unless they are in writing. The embarrassment and difficulty involved in resolving such a dispute is likely to be increased by the fact that, by contrast with other types of instructions over which dispute may arise, the instructions being alleged by the solicitor are in his or her personal interests. A further difficulty is that instructions may be given without an adequate understanding of the reasons for which the withdrawal is to be made, nor of the rights which the client is forgoing by giving those instructions.

5.28 In some jurisdictions, such as Queensland,[33] the client's instructions to make withdrawals for costs or disbursements are sufficient justification for doing so provided that they are in writing. In our Discussion Paper we suggested a similar approach.[34] The Law Society responded by questioning the utility of requiring instructions to be in writing.[35] It said that there would be nothing to prevent a solicitor obtaining a very broad authorisation from the client well in advance. For example, upon commencing to act for a client a solicitor might obtain the following instructions from the client:

> "You are hereby authorised to deduct at the appropriate time your proper costs and disbursements in this matter from moneys you are holding or may or wi 'II receive on my behalf."

Moreover, the Society said that the instructions might be given without the client being aware of his or her rights to require a bill and to have it taxed.

5.29 A possible response to the Law Society's criticisms is to require that the clients authorisation must either be in a prescribed form which entails a reasonable degree of specificity, or must have attached to it the bill which is to be paid pursuant to it. In addition, the authorisation could be required to include a prescribed form of explanation of clients rights to refuse to sign authorisations, their rights if they do sign them, and their rights if they do not sign them.

Without Clients' Instructions

5.30 The second major question concerning withdrawals for costs or disbursements is whether there are circumstances in which they should be permissible without the clients instructions. We have explained earlier that until 1976 solicitors in New South Wales believed that they could make such withdrawals without clients instructions. They now can do so only if they have a particular lien.

5.31 An idea of the range of situations in which solicitors could be given the right to withdraw without their clients instructions can be obtained by looking at the present position in other jurisdictions. In some Jurisdictions, including Victoria,[36] England[37] and Ontario,[38] solicitors may withdraw money for *disbursements* provided that they have been made already, and money for *costs* provided that a bill, or other written notification of the amount of costs, has been delivered" to the client In England, the client must also be notified in writing that the money is being or will be applied towards or in satisfaction of the costs."[39] The law societies in Victoria and South Australia have advised their members that they should "issue a bill of costs to the client wherever costs are taken from the trust account and [not] take such costs until the client has had proper opportunity to object."[40]

5.32 In Queensland, withdrawals without clients instructions are permissible in the following circumstances only:

> where a bill has been rendered and taxed;
>
> where "an untaxed Bill of Costs has been delivered to the client and at the expiration of one month after delivery no evidence exists of any objection by the client to the quantum thereof; or
>
> where the solicitor has made disbursements "on the client's instructions".[41]

5.33 In our Discussion Paper we Suggested that solicitors should be entitled to withdraw money for disbursements, without obtaining their clients instructions or rendering a bill.[42] But we suggested that withdrawals for costs should not be permitted until a bill not necessarily in detailed form, has been delivered and one month has expired without objection from the client as to quantum.[43] This suggestion was based on the Queensland provisions referred to above, and was influenced by the existing statutory requirement in New South Wales that before suing for costs or disbursements solicitors must deliver a detailed bill and wait one month to see whether the client requires the bill to be taxed.[44] The Law Society's response agreed in effect with our suggestion save for the proposed one-month waiting period.[45]

5.34 In view of the broad consensus on many issues raised above, including the requirement to deliver a bill before withdrawing for costs, we concentrate here on the principal area of disagreement, namely the question of a one-month waiting period after delivery of the bill. The main arguments in favour of such a period are that clients should be given a reasonable amount of time in which to consider whether to challenge a bill, and pending the determination of such a challenge solicitors should not be able to gain the great advantages of paying themselves the money in dispute. We have mentioned the existing statutory requirement of a one- month period between delivering a bill (which must be in taxable form) and suing the client for payment. The argument for such a protection is, if anything, stronger in relation to withdrawing from a trust account than it is in relation to suing.

5.35 It is important to bear in mind in this context that withdrawals for costs or disbursements have been a major area of trust account abuse in New South Wales in recent years. They have caused serious harm to clients, substantial losses for the Solicitors Fidelity Fund, and great damage to the reputation of the profession.[46]

5.36 The Law Society argues, with some justification, that if the procedures for withdrawing money without the clients instructions are made too onerous, many solicitors may make a practice of obtaining general instructions to withdraw almost whatever they want whenever they want it.[47] There is no shortage of clients who could be persuaded to sign such authorisations without really understanding the consequences. However, as we have mentioned earlier,[48] one response to this argument is to tighten up the requirements concerning written instructions. The Society also points out that some people, such as travel agents, have a statutory right to withdraw money from their trust accounts for costs and disbursements.[49] It may be doubted, however, whether such rights are appropriate and, in any event it may be argued (as the Law Society has done in other contexts, such as conveyancing) that solicitors have a useful “selling point” for their services if they can point to stringent protections for their clients which do not apply to other occupational groups.

5.37 A further argument put by the Law Society is that solicitors are less likely to undertake work for clients who are not demonstrably well-to-do if they do not have the security of knowing that any trust money held for such a client can be withdrawn to pay their costs or disbursements. Solicitors, it is argued, may refuse to act for such clients or may insist on conducting credit-worthiness checks. One response to this argument is that many other professions and occupational groups are in this position. Another is that it is now eight years since solicitors “lost” what they had hitherto regarded as a right to withdraw without the client s instructions, yet there is no evidence that this “loss” has increased the reluctance amongst solicitors to act for less-wealthy clients. Furthermore, if solicitors were permitted to withdraw money one month after rendering a bill (in the absence of objections, they would be in a better position than at present, since they are now unable to withdraw without instructions unless they have a particular lien and obtain a court order.

5.38 If a one-month period is to be adopted, the question arises as to what action the client must take during that time it he or she wishes to prevent withdrawal from the trust account. An obvious possibility is to require the client to seek taxation, which would involve as a prelude the preparation by the solicitor of a bill in taxable form. Another possibility, which in practice may not be very different, is merely to require the client to raise “an objection” which is the term used in the Queensland provision.[50] Presumably, the solicitor would then have to pursue the procedure for suing, which under present law involves the preparation of a bill in taxable form and the client having one month thereafter to seek taxation.[51]

5.39 A major difficulty with both of these possibilities is the substantial inconvenience, delay and expense involved in the present taxation system. It is widely agreed that the system is inadequate from the viewpoints of

both solicitors and clients. It is beyond the scope of this Report to propose reforms of that system. If, however, a simpler, quicker and cheaper procedure was introduced, clients could be required to resort to this new procedure within one month of receiving a bill if they wish to dispute withdrawals for costs of disbursements.

C. Refusal to Withdraw from a Trust Account

5.40 Solicitors' "particular lien" relates only to money obtained for a client by a solicitor as a result of litigation or arbitration.[52] It is difficult to see why money of this kind should be treated differently from other money received by the solicitor for or on behalf of a client, such as money obtained by negotiation, investment or some other non-litigious process. This is true not only in relation to solicitors withdrawing the money in order to pay it to themselves ("active enforcement") but also to solicitors refusing, despite the client's instructions, to withdraw the money and pay it to the client or some other person. If a general procedure is specified by which solicitors may withdraw trust moneys for costs or disbursements without having their client s instructions to do so, there seems no good reason to retain a special procedure in relation to moneys of the kind now covered by a particular lien. If this special aspect of a particular lien is abolished, there then ceases to be any reason for preserving a distinction between particular liens and general liens.

5.41 We have referred earlier[53] to the doubt which currently exists about whether or not the solicitors "general lien" over trust moneys has been overridden by statute in New South Wales. It is obviously desirable that as important a question as this should be clarified authoritatively, preferably by statute. There is no doubt that a general lien is of considerable assistance to solicitors since in many cases it provides them with a substantial measure of security for their costs and disbursements. In the absence of such a lien they may be more inclined to require full payment in advance, or to conduct creditworthiness checks, before agreeing to act for a client. Moreover, if there were no general lien, and solicitors were required to render a bill and wait one month before withdrawing their costs or disbursements, clients could withdraw all their trust money before the month expired. This could be seen as putting solicitors at an unfair disadvantage.

5.42 On the other hand, the general lien can enable some solicitors to bring undue pressure on clients to pay bills which are unreasonably high. The procedures by which clients can challenge bills and thus recover trust money to which their solicitor is not properly entitled are cumbersome, expensive and slow. These disadvantages may affect both solicitor and client, but they tend to fall more heavily on the latter. This is especially so since the client will usually have to pay another lawyer to pursue this course of action and unless the bill is reduced by at least one-sixth on taxation the client will have to bear the costs incurred by his or her original lawyer in the course of the taxation process.[54]

IV. RECOMMENDATIONS

A. Introduction

5.43 Our recommendations emerge from the preceding discussion and the principal reasons for them have been canvassed in the course of that discussion. Where money is paid to a solicitor for or on account of costs and disbursements we consider that in order to protect the client and to ensure adequate records of the transaction it should have to be paid into the trust account or, where it falls within an exemption from that requirement, should

have to be recorded in a register which forms part of the trust account records. We consider also that, generally speaking, solicitors should not be permitted to appropriate clients' money to themselves for their costs or disbursements unless, prior to the appropriation the clients have been adequately informed in advance and have approved, or acquiesced in the proposed appropriation. In order to ensure adequate protection for clients, and to avoid subsequent confusion or dispute, detailed rules are necessary in relation to the types of information which must be provided to clients, the ways in which their approval may be indicated, and the procedures to be followed before their acquiescence can be presumed.

5.44 On the other hand, solicitors should not be allowed to hold their own money in their trust account, thereby confusing the management and records of that account, and also depriving potential creditors of access to the solicitors resources. Accordingly, they should not be permitted to pay their own money into their trust account, and should be required to withdraw their own money from their trust account within a reasonably short time of being entitled to do so.

5.45 We turn now to detailed recommendations in relation to respectively, payment into a trust account, withdrawal from such an accounts and refusal to withdraw from such an account of money for or on account of costs or disbursements.

B. Payment into a Trust Account

5.46 **We recommend that money received for or on account of costs or disbursements should have to be paid into a trust account unless**

> **the client has given written instructions for the money to be handled in some other way, and before or upon receipt of the money the solicitor delivers to the client an outline bill or receipt identifying the services or disbursements for which the money is being paid; or**
>
> **work has been done or disbursements have been made, an outline bill has been delivered to the client, and the money is applied towards payment of that bill.**

If either of these two exceptions applies,

> **the money must not be paid into a trust account, unless in the case of the first exception the client's instructions leave the solicitor with a discretion as to whether or not the money is to be so paid pending its payment elsewhere; and**
>
> **the transaction must be recorded in the Direct Payments Register, the establishment of which we have recommended earlier in this Report.**

5.47 **If work has not been done, or disbursements have not been made, at the time of receipt of the money, but it is done or they are made, and a bill is delivered, before the next banking day, the money**

must not be paid into a trust account (if such payment into the trust account has not already occurred before the bill is delivered).

5.48 **In order to constitute an "outline bill", a bill should contain sufficient particulars to enable the general nature and scope of the work and/or disbursements to be identified and to be distinguished from other work done or likely to be done, or disbursements made or likely to be made, for the client in question. The bill should indicate the period which it covers.**

C. Withdrawal from a Trust Account

5.49 **We recommend that a solicitor should not be permitted to withdraw money from a trust account for or on account of his or her own costs or disbursements unless**

the solicitor has delivered to the client an outline bill, and the client has thereafter given written instructions, in a prescribed form, for the withdrawal to be made;

the solicitor has delivered to the client an outline bill, attached to which is a statement in a prescribed form that money to meet the bill will be withdrawn from the trust account unless the client objects within one month to the quantum of the bill, and no such objection has been made;

the solicitor has made disbursements on the instructions of the client; or

the withdrawal is made to satisfy a judgment debt owed by the client to the solicitor.

5.50 **The prescribed form for written instructions should include a statement explaining to the client that he or she is under no obligation to sign the form, and outlining the rights which he or she has if the form is signed, or is not signed, respectively.**

5.51 **If a client objects to the outline bill within one month, the solicitor should then have to prepare and deliver a bill in taxable form. If the client does not seek taxation within one month after receiving the taxable bill, the solicitor should be entitled to withdraw sufficient money to meet the bill.**

5.52 **Where a solicitor has become entitled to withdraw money in accordance with these rules, he or she should be required to make the withdrawal within one month of becoming so entitled, save where the entitlement relates either to disbursements or to work which has not yet been completed.** The main purpose of this recommendation is to ensure, so far as is reasonable, the separation of trust money from money which the solicitor has become entitled to pay to himself or herself. Withdrawal for these purposes means withdrawal from the trust account entirely, not merely transfer to a trust ledger account in the solicitor s name rather than that of the client. It Would be lawful, however, to maintain in trust records certain entries which indicate amounts that the solicitor may become entitled to withdraw for costs or disbursements, provided that those entries do not have the effect, or purport to have the effect of making the solicitor the beneficial owner of the money in question.

D. Refusal to Withdraw from a Trust Account

5.53 **We recommend that the particular lien presently enjoyed by solicitors in relation to certain money received by them should be abolished. The uncertainty about whether or not solicitors in New South Wales have a general lien over trust money should be resolved by legislation. We do not necessarily oppose the existence of such a lien (at least in relation to trust money), provided that in addition to, or in substitution for, the existing system for taxation of costs a new system for reviewing bills of costs is established which is fair to both solicitors and clients but is simpler, quicker and cheaper than the existing taxation process.**

FOOTNOTES

1. Legal Practitioners Act, 1898, s.41(3).

2. *See Stewart v. Strevens* [1976] 2 N.S.W.L.R. 321, at p.325 per fielsham in Eq. 3. *Ibid.*

4. See paras.4.40, 4.42 and 4.46 above.

5. See para.4.40 above.

6. *Stewart v. Strevens* [1976] 2 N.S.W.L.R. 321 (Helsham C.J. in Eq.).

7. *Id*., esp. at pp.327-9. See also, *Re a Barrister and Solicitor* (1979) 40 F.L.R. 26 (Full Court of the Supreme Court of the A.C.T., at pp.39-40; and *Johns v. Law Society of New South Wales* [1982] 2 N.S.W.L.R. 1, at p.21, per Hope J.A.

8. *Ibid.*

9. *Johns v. Law Society of New South Wales* [1982] 2 N.S.W.L.R. 1, at p,18, per Moffitt P.

10. *Ibid*., and at p.20, per Hope J.A.

11. See note 5.7.1 above.

12. See, e.g., J. Disney and others, *Lawyers* (Law Book Co., Sydney, 1977), pp.532-536.

13. See, e.g., *Stewart v.Strevens* [1976] 2 N.S.W.L.R. 321, at p.325.

14. Legal Practitioners Act, 1898, s.21.

15. *Johns v. Law Society of New South Wales* [1982] 2 N.S.W.L.R. 1, at p.24, per Mahoney J.A.

16. *Ibid.*

17. See para.5.5 above.

18. See generally G.J. Graham-Green, Cordery *on Solicitors* (7th ed., Butterworths, London 1981), pp.273-6; and cases cited in note 5.13.2 below.

19. See Helsham C.J. in Eq. in *Stewart v. Strevens* [1976] 2 N.S.W.L.R. 321, at pp.327-329; *Shand v. M.J. Atkinson Ltd.* [1966] N.Z.L.R. 551, esp. per Turner J. *Cf. Loescher v. Dean* [1950] 1 Ch 491. See also *Johns v. Law Society of New South Wales* [1982] 2 N.S.W.L.R. 1, at pp.20-21, per Hope J.A.

20. See *Shand v. M.J. Atkinson Ltd.* [1966] N.Z.L.R. 551, esp. at pp.564-568, per Turner J., and at pp.568-570, per McCarthy J. But see also *Stewart v. Strevens* [1976] 2 N.S.W.L.R. 321, at pp.328-329.

21. Discussion Paper, paras.4.31-4.32.

22. Law Society's Response, para.2.6(d).

23. *Ibid.*

24. Solicitors' Accounts Rules 1975, r.9(2) (a).

25. Law Society Regulations, reg.18(5) (a).

26. Rules of the Law Society of British Columbia, ch.5., art. 1.2(e). In that province a "specific", rather than a "written", authorisation by the client is necessary.

27. See para.4.20 above.

28. Solicitors' Account Rules 1975, r.9(2) (b) and (c).

29. Law Society Regulations, reg.18(6) (b).

30. Discussion Paper, para.4.39.

31. Law Society's Response, para. 2.6(d).

32. See paras.4.15-4.39 above.

33. Trust Accounts Act 1973, s.8(1) (c).

34. Discussion Paper, para. 4.73.

35. Law Society' s Response, para. 2.11 (g).

36. Solicitors (Audit and Practising Certificates) Rules 1965, r.20.

37. Solicitors' Accounts Rules 1975, r.7(a) (ii) and (iv).

38. Law Society Regulations, reg.18(8) (b) and (c).

39. Solicitors' Accounts Rules 1975, r.7(a) (iv).

40. See Law Society Bulletin (S.A.) (Nov.1978), Supplement and Law Society of S.A., *Legal Practitioners Trust Accounts Manual,* p.38.

41. Trust Accounts Act 1973, s.8(1) (c).

42. Discussion Paper, para.4.73.

43. *Ibid.*

44. Legal Practitioners Act, 1898, s.21.

45. Law Society's Response, para.2.11.

46. See, e.g., the Solicitors' Statutory Committee cases of *Rogers* (No.20 of 1980), *Baker* (No.11 of 1982), *Turvey* (No.3 of 1981); and *Peet* (1980) 18 Law Society Journal 15.

47. Law Society's Response, para.2.11(g).

48. See para.5.29 above.

49. Law Society's Response, para.2.1 I (d). See, e.g. Travel Agents Act, 1973 (N.S.W.), s.42C(1) (b).

50. Trust Accounts Act 1973, s.8(1) (c) (ii).

51. See Legal Practitioners Act, 181)8 (N.S.W.), s.21,

52. See paras.5.5 and 5.12 above.

53. See paras.5.13-5.14 above.

54. Legal Practitioners Act, 1898, s.28.

6. Recording and Accounting for Trust Money

I. INTRODUCTION

6.1 In the course of previous chapters, we have considered some issues relating to recording and accounting for the manner in which trust money has been handled. In particular, we have recommended that, where trust money is not paid into a trust account- details of it and of the manner in which it is handled should have to be recorded in a Direct Payments Register constituting part of the solicitor's trust account records.[1]

6.2 In this chapter we consider a number of other issues relating to recording and accounting for trust money. They concern the following areas:

- opening files and retaining records;
- computerised trust accounts;
- statements of account to clients;
- trial balances and bank reconciliations.

II. OPENING FILES AND RETAINING RECORDS

A. The Present Position

6.3 Solicitors in New South Wales are under no statutory obligation to open files in relation to work which involves the handling of trust money. Nor are they under an obligation to retain any such files for a specified period. Trust account records, however, must be retained for five years.[2] It is relevant to note also that Commonwealth income tax legislation requires every person carrying on a business to keep and retain for seven years sufficient records of income and expenditure to enable his or her tax liabilities to be readily ascertained.[3]

B. Discussion

Opening Files

6.4 It is obviously desirable that sufficient records be maintained to enable the nature of a trust money transaction to be ascertained, including the nature of any instructions allegedly given by the client. The likelihood of such records being made would be increased if a file had to be opened, rather than reliance being placed solely on brief entries in the trust account records. Adequate records are of importance not only to the solicitor and client but also to any accountant or inspector who may be charged with responsibility for examining solicitors' trust account records. In chapter 9 we recommend that, as in many other Jurisdictions, such accountants and inspectors should have access to the solicitor s office files to assist their understanding of particular entries in the trust account records.[4]

6.5 The principal argument against requiring a file to be opened for every matter Involving trust money is the work and expense which might be involved. On the other hand, most solicitors now open a file in every such matter anyway. Where files are not opened, it is usually because the matter is very short-lived. In such situations the requirement to record adequate details of the trust money transaction in a file is not likely to be burdensome, yet may be of considerable value in the event of subsequent uncertainty or dispute.

6.6 In Victoria, solicitors are required not only to keep "accounting records" of trust moneys but also to "keep such files or other records as will explain" their trust money transactions.[5] In our Discussion Paper we suggested the adoption of a similar requirement in New South Wales.[6] The Law Society, however, responded that it was "not at present persuaded that the additional work and cost to the client ... would be warranted by any substantial increase in information which would be forthcoming."[7]

Retaining Records

6.7 Some important types of legal action which may be taken against solicitor trustees can be brought as long as twelve years after the events in question, without being barred by statute for lapse of time.[8] Indeed, there are circumstances in which such actions could be brought more than twelve years after the solicitor closed his or her file on the matter. This may apply, for example, where the beneficiary was a minor at the relevant time, or did not suffer damage until a later date.

6.8 In South Australia, trust ledger accounts are required to be kept for 15 years, while other trust account records and "files relating to trust transactions" must be kept for seven years.[9] Similar rules apply in Victoria, save that trust ledger accounts must be kept "indefinite".[10] In New Zealand, trust ledgers must be kept for 20 years, "files relating to matters for which trust accounts have been held" for 10 years, and other trust account records for 7 years.[11] In our Discussion Paper we suggested that files relating to trust transactions should have to be kept for at least 12 years after the date on which the file ceased to be active.[12] The Joint Legislation Review Committee of the two principal associations of accountants in New South Wales agreed,[13] but the Law Society said that while the suggestion

> "may be justifiable in theory ... its substantial costs, and therefore the substantial cost to the public, should be assessed and weighed against the results which can be expected to be achieved over a period of twelve years in the way of discovery of frauds, defalcations, illegalities and irregularities."[14]

The Society has indicated, however, that trust account records should have to be retained for six years, rather than as at present, for five years.

6.9 There is no doubt that the cost of storing records can be substantial. On the other hand, modern technology is rapidly reducing many of the problems which might otherwise arise from a requirement to retain records for substantial periods. Moreover, as we have described in an earlier chapter,[15] the cost occasioned to the public and the profession by trust account defalcations is extremely high. A number of these defalcations have not been discovered for some years (in at least one instance, some decades) after they occurred.

C. Recommendations

6.10 **We recommend that solicitors should be required to open a file for every matter which involves the handling of trust money, and to record in that file such information as, in conjunction with the trust account records, will explain all trust money transactions involved in the matter in question.**

6.11 We recommend also that solicitors should be required to retain

all trust ledger accounts, cash books and journals for at least 12 years, and all other trust account records for at least seven years, after the last entry appearing in them;

all Direct Payments Registers (and the Securities and Investments Register, the establishment of which we recommend in chapter 11), for at least 12 years; and

all files relating to trust money transactions for at least 12 years after the date of the last transaction.

III. COMPUTERISED TRUST ACCOUNTS

A. The Present Position

6.12 There is at present, a highly detailed set of statutory regulations in New South Wales specifying the forms of trust account records which must be kept by solicitors, the types of information which must be entered in those records, and the procedures by which those entries must be made.[16] The regulations were drawn up before the advent of computerised accounting and many of the requirements, particularly those concerning the different types of books which must be maintained, cannot be satisfied readily, if at all, by computer-based accounting systems.

6.13 A number of solicitors' practices now rely entirely or partly on computerised systems for their trust account records. The Law Society, although it has no specific statutory power to do so, has given approval to some eleven software packages for the operation of solicitors trust accounts, even though they do not comply with the

current statutory regulations.[17] We understand that these approvals have been given on an ad hoc basis after examination of the particular package in question.

6.14 Several years ago the Law Society drafted new regulations[18] which were intended to suit computerised systems as well as manual or mechanical ones. This draft included a number of specific requirements about the type of information which must be recorded but, in addition, it required that all trust account records must be in a form which has the "written or published approval, of the Society. The intention we understand, was that the Society would thus be able to assess technological innovations as they occur and to make decisions from time to time about the suitability of particular systems, whether generally or in relation to an individual solicitors practice.

6.15 These draft regulations were submitted by the Society to the Attorney General for the approval of the Governor, which it was necessary for them to obtain in order to become law. However, the Attorney General took the view that any amendments to the regulations should await our Report on trust accounts. Accordingly, the draft regulations have not come into effect. The Society has amended its draft from time to time, and its current draft is printed in Appendix III of this Report.

6.16 In 1983, the Law Society resolved to adopt a somewhat different approach to regulation of computerised systems. It commissioned from a prominent firm of accountants, Deloitte Haskins and Sells, a set of specifications for computerised trust accounting systems, and worked closely with that firm in identifying the features which such systems should have in order to provide sufficient records and protections. The specifications were then made available to a number of computer software companies with an invitation to develop programmes which complied with the specifications and to submit them for the Society's approval. The Society's intention we understand, is that solicitors wishing to use computerised systems will be required to use one or other of these approved programmes, save that there will be exemptions for solicitors who obtained approvals prior to the introduction of this new regime. We have been informed by the Society that seven programmes have been submitted and are currently under consideration.

B. Discussion

6.17 There can be little doubt that the existing regulations should be amended in order to allow computerised accounting systems. It has been amply demonstrated that computers can make accounting systems much more efficient, with consequential benefits for both solicitors and clients. On the other hand, there is a clear need for caution. In some ways computer systems can be more vulnerable to fraudulent misuse, and less capable of being subjected to effective independent scrutiny, than some other systems. This applies especially if, for example, the system does not retain a full history of entries in the records or allows such history to be readily falsified. Difficult problems arise also in relation to preventing unauthorised access to the system, and in producing records in readily comprehensible form.

6.18 A further consideration is the general desirability of the regulations comprising a specific and comprehensive collection of the rules with which trust account systems must comply, rather than leaving most of the requirements to be determined by the Law Society when considering applications for approval. However, the complexity of the requisite rules in relation to computerised systems, and the rapid pace of technological innovation make this goal exceedingly difficult to achieve. Undue rigidity, and unfairness to the manufacturers and potential users of certain systems, might result from over-emphasis on the importance of expressing all necessary principles in the form of regulations. The use of computerised systems is still relatively new within the

legal profession especially in small or medium-sized firms, as well as in other professions. A few more years of experience may make it easier to develop specific and reasonably comprehensive regulations, notwithstanding the unlikelihood of a slackening in the pace of innovation.

6.19 We know of no jurisdiction in which substantial and detailed rules for computerised trust account systems have been developed, whether in statutory form or otherwise. In our Discussion Paper we suggested that the Law Society's draft regulations were too vague in many respects.[19] We published in the Paper a set of draft regulations which sought to be more specific and to provide a virtually complete list of requirements with which trust account systems must comply.[20]

C. Recommendations

6.20 We have referred to the difficulties currently involved in drafting suitable regulations for computerised systems. It is, nevertheless, essential that detailed rules be developed and published, and that before too much longer they should be expressed, as far as possible, in statutory regulations. This task will need the continuing and close attention of a special committee drawn from the ranks of solicitors, accountants, computer experts and legislative drafters. It is a goal towards which the Law Society has already made valuable progress but which in our view, the Government should now clearly endorse and take an active role in pursuing. After all, any regulations proposed by the Law Society cannot become law without the Government's approval[21] and, indeed, the Government has power to make regulations of its own volition[22] or to effect changes by amendments to the Legal Practitioners Act.

6.21 Pending completion of this task, it is necessary to provide a means by which new systems can be approved. This can be achieved by allowing the Law Society to grant approvals, as would be the case under its draft regulations, especially regulation 2.[23] It is also desirable that some of the improvements to the current regulation which the Law Society has proposed should be introduced without further delay. We refer here to the basic "book-keeping" aspects of the Society's draft regulations (that is, regulations 3-9, and 11).[24] Other aspects, such as the draft regulations relating to accountants' examinations, solicitors' nominee companies and statements of account to clients are considered later in this Report.

6.22 Accordingly, **we recommend that the Solicitors Trust Account Regulations should be amended to give the Law Society of New South Wales power to approve trust accounts recording systems, and that other amendments to the basic " book-keeping" aspects of those regulations should be made along the general lines of regulations 3-9 and 11 of the Law Society's draft reproduced in Appendix III of this Report.**

6.23 **We recommend also, however, that within the next three years the regulations should be further amended to provide more specific and comprehensive rules relating to the keeping of trust account records, including those which are in computerised form, and to reduce substantially the need for the Law Society to be involved in an extensive "approval" or exemption" role. We recommend that the Attorney-General should establish a special committee to monitor the operation of the interim regulations which we have recommended in the previous paragraph, and to develop proposed new regulations (and such non- statutory rules, guidelines or other material as it may consider necessary) for submission to the Government in not more than three years time.**

6.24 **An appropriate composition for the special committee which we have recommended would be the Auditor General (as chairperson), two representatives of the Law Society, one representative each of the Institute of Chartered Accountants and the Australian Society of Accountants, one or two experts in computers, and the Parliamentary Counsel or his or her nominee.**

IV. STATEMENTS OF ACCOUNT TO CLIENTS

A. The Present Position

6.25 Solicitors in New South Wales are under no general statutory duty to provide clients with statements of account concerning trust moneys which they have received for or on behalf of those clients. The only specific duty in this regard relates to

> "any moneys... received by any solicitor from any person other than his client ... in or towards satisfaction of any claim or demand arising from death or personal injury, being moneys received for damages, compensation, expenses, costs or disbursements",[25]

provided that the total received exceeds $100. The duty is to render to the client a statement of account showing

> "(a) all moneys so received;
>
> (b) all moneys paid to the solicitor by the client in connection with the same manner;
>
> (c) the disbursement of any such moneys; and
>
> (d) the balance remaining undisbursed."[26]

These statements must be in sufficient detail to enable them to be "conveniently and properly audited",[27] and they must be rendered no more than three weeks after the end of the quarter in which the money was received. The duty must be complied with notwithstanding any waiver or direction to the contrary by the client."[28]

B. Discussion

6.26 Statements of account can be of substantial benefit to clients by enabling them to keep track of trust money held on their behalf by solicitors, and to raise questions, if necessary, about the way in which the money is being handled. This applies especially if the clients receive statements on a regular basis rather than only after

completion of the matter in question. Their affairs may be conducted more carefully, and yet more expeditiously, if the solicitor is having to account to them regularly.

6.27 Statements of account can also have benefits for solicitors. The requirement to render them, especially if regular rendering is required, can be a valuable incentive for the development of more efficient accounting systems, regular review of matters, and expeditious completion of matters where possible. Clients are likely to be favourably impressed by solicitors who keep them adequately informed on a regular basis about the way in which their affairs are being conducted. They are less likely in such a situation to burden their solicitor personally with continual inquiries, often at times when the solicitor is immersed in other matters.

6.28 Concernhasbeenexpressedbysomesolicitorsaboutthecostwhichmightbelnvolved if regular statements had to be provided at, say, quarterly intervals. Several points need to be considered in response to this concern. First, the cost would not be substantial if solicitors designed their accounting systems with the requirement to provide quarterly statements in mind. Secondly, many solicitors already provide regular statements or have systems which would enable them to do so without substantial expense. Thirdly, a very substantial number of matters are completed by solicitors within a few months, so that few, if any, quarterly statements would be necessary. Thus, the cost of providing quarterly statements may not be very much higher than the cost of providing a statement upon completion. Fourthly, the need to provide quarterly statements might encourage solicitors to deal more expeditiously with some matters and to ensure that trust ledger accounts are closed as soon as possible. Finally, it will often be possible to send statements at the same time as other material's being forwarded to the client, or to hand them to clients when seeing them for other purposes.

6.29 In Queensland, there is a statutory duty to provide statements of account within 14 days of a request by the client.[30] There is also a specific duty, as in several other States, to provide statements of account in relation to investment of clients' money.[31] In New Zealand, a statement "detailing the application of a client's [trust] funds" must be sent

> (a) in respect of ongoing investment transactions at intervals of not more than 12 months;
>
> (b) in respect of all transactions which are not completed within 12 months at intervals of not more than 12 months; and
>
> (c) in respect of all other transactions promptly upon or prior to the completion of the transaction".[32]

A survey of accountants in New South Wales undertaken in 1979 by the Accounting Research Centre found that more than 80 per cent of respondents considered that solicitors should be required to "submit to clients, from time to time, a statement of the client's trust account".[33]

6.30 In our Discussion Paper we suggested that there should be a duty to provide a statement "not only after the completion of any matter but also at intervals of, say, three months during the matter."[34] The Law Society responded that "on a cost/benefit analysis, [this suggestion] cannot be justified.[35] We understand, however, that the suggestion has some Support within the ranks of the Society. Moreover, although the Society does not favour regular statements, it has proposed a statutory duty to provide statements "as soon as practicable alter completion of the matter... and at any time upon request of the client".[36] It has also proposed a duty, where a solicitor has "acted for a client in the investment upon loan of any trust moneys", to provide a statement of

prescribed particulars of the transaction "as soon as practicable after payment... to the borrower."[37] The Joint Legislation Review Committee of the two principal associations of accountants in New South Wales agreed with our suggestion that regular statements should be required, but it favoured six-monthly rather than quarterly statements.[38]

C. Recommendation

6.31 We consider that the provision of statements of account especially on a regular basis, can be of great benefit to clients and can also have advantages for solicitors. A requirement to provide such statements can reasonably be expected to reduce the incidence of deliberate or unintentional mishandling of trust moneys. In our view, these advantages outweigh the resources required to provide the statements, especially since the development of efficient office systems can reduce substantially the additional resources required for this purpose.

6.32 Accordingly, **we recommend that where solicitors receive trust money for a client they should be required to provide the client with a statement of account in relation to that money**

> **where the matter is not completed within six months - not more than six months after its commencement and at intervals of not more than three months thereafter;**
>
> **within one month of completion of the matter in question; and**
>
> **at any other time upon request by the client.**

We recommend also that this duty should not be capable of being waived by the client.[39] Where quarterly statements are required, it may be convenient for solicitors to make them in relation to the financial quarters ending March, June, September and December.[40] The question of a specific duty to provide statements of account upon investing trust money is considered in chapter 11 of this Report when we look at a number of issues concerning investment.[41]

6.33 **The statements of account should be required to provide particulars of all receipts and payments of trust money, and the total amount of any such money remaining. Each statement should be deemed part of the solicitor's trust account records and accordingly be subject to independent scrutiny.**

V. TRIAL BALANCES AND BANK RECONCILIATIONS

6.34 Solicitors in New South Wales are required to prepare trial balances of their trust ledgers at the end of each quarter, and an end-of-year reconciliation between their trust account records and their bank statements.[42] The Law Society of New South Wales has proposed that the preparation of trial balances and bank reconciliations should have to be carried out as at the end of each month and within twenty days of that date.[43] We agree with

this proposal which is similar to existing requirements in several other Australian jurisdictions, and we recommend accordingly.

FOOTNOTES

1. See paras.4.35-4.39 above.

2. Solicitors Trust Account Regulations, reg.3(2).

3. Income Tax Assessment Act 1936, s.262A.

4. See para.9.77 below.

5. Legal Profession Practice Act 1958, s.41(1)(b).

6. Discussion Paper, para.6.79.

7. Law Society's Response, para.5.15.

8. Limitations Act, 1969 (N.S.W.), s.47.

9. Legal Practitioners Regulations 1982, reg.25.

10. Solicitors (Audit and Practising Certificate Rules) 1965, r.40.

11. Solicitors Trust Account Rules 1969, r.13.

12. Discussion Paper, para.6.84.

13. N.S.W. Joint Legislation Review Committee of the Australian Society of Accountants and the Institute of Chartered Accountants of Australia "Preliminary Reply to Discussion Paper No.6 of N.S.W. Law Reform Commission and Submission by N.S.W. Law Society: Auditing of Solicitors' Trust Accounts (1983), para.20 (hereafter referred to as the "Joint Committee Reply").

14. Law Society's Response, para.5.17.

15. See Chapter 2 above.

16. See Solicitors Trust Account Regulations.

17. Information supplied by the Law Society of New South Wales at the request of the Commission.

18. For the draft as it stood in late 1981, see Appendix I to our Discussion Paper. For the current draft-see Appendix III of this Report.

19. Discussion Paper, paras.5.19-5.21.

20. *Id.*, Appendix II.

21. Legal Practitioners Act, 1898, s.86(1) and (3).

22. *Id.*, s.87.

23. See Appendix III.

24. *Ibid.*

25. Solicitors (General) Regulations, reg.28(l).

26. *Ibid.*

27. *Ibid.*

28. *Ibid.*

29. *Id*., at reg.28(2).

30. Trust Accounts Act 1973, s.13.

31. See para. 11.20 below.

32. Solicitors Trust Account Rules 1969, r.6(6).

33. University of Sydney Accounting Research Centre, “A Report of Fiji Enquiry into the Certification of Accountants of Solicitors’ Trust Accounts” (1980), p.15.

34. Discussion Paper, para.6.45.

35. Law Society’s Response, para.4.5

36. See the Society’s draft Solicitors Trust Account Regulations, reg.10 in Appendix III of this Report.

37. *Ibid.*

38. Joint Committee Reply, para.5.

39. As mentioned earlier, a provision of this nature already applies in relation to moneys received in the course of conducting claims for death or personal injury (see para.6.25 above).

40. *Ibid.*

41. See paras. 11.18-11.26 below.

42. See para.7.18 below.

43. See the Society’s draft Solicitors Trust Account Regulations (Appendix III of this Report), reg. 11.

7. Independent Scrutiny: An Outline of The Present Position

I. INTRODUCTION

7.1 This is the first of four chapters concerned with independent scrutiny of trust accounts. In this chapter we outline the present position in New South Wales in relation to the two principal forms of independent scrutiny, namely

> Law Society inspections and investigations; and
>
> accountants examinations

We then discuss and make recommendations about certain central issues relating to, respectively, Law Society inspections and investigations (chapter 8) and accountants' examinations (chapter 9). In chapter 10 we consider a number of other issues relating to these two forms of scrutiny, and also consider a third form, namely the imposition of duties on solicitors and others to disclose suspicions they may form that certain solicitors trust moneys have not been correctly handled or recorded.

II. LAW SOCIETY INSPECTIONS AND INVESTIGATIONS

A. Inspections

7.2 The Law Society of New South Wales has been vested by statute with the power to appoint persons as "inspectors" in order to "examine, either generally or in a particular case, the [trust] accounts kept ... by any solicitor."[1] There is no need for the Society to suspect irregularities before appointing an inspector. Any such inspector

> "may require any person to produce to him... the accounts concerned and any books, papers, securities or other documents in the possession of the person or under his control relating to those accounts, and to give all information in relation thereto, and to furnish all authorities and orders to bankers and other persons that may be reasonably required of him."[2]

7.3 An inspector is empowered to provide the Law Society with "a confidential report as to the state of any accounts he is appointed to examine", and must provide such a report if the Society so requires.[3] A copy of any such report must be provided to the solicitor in question and if the report states that in the inspectors opinion "there are reasonable grounds to suspect that there has been an irregularity or professional misconduct" in

relation to the accounts in question, it must also be sent to the Attorney General.[4] The Society is entitled to call upon the solicitor to provide a written explanation of any matter in the report relating to his or her accounts.[5] There are also certain statutory provisions aimed at preserving due confidentiality of information obtained by inspectors, and of their reports, but the Society has powers to make disclosure in certain circumstances to the police or for the purposes of disciplinary action.[6]

7.4 The Law Society currently employs twelve qualified accountants as Trust Account Inspectors[7] and has exercised the powers referred to above by appointing each of them as an inspector in relation to solicitors' trust accounts generally. The Society s Inspectors undertake two types of inspection which we shall refer to as routine[8] and special inspections respectively. These inspections are made without cost to the solicitor concerned.

7.5 The Society has adopted the objective of ensuring that the trust accounts of every solicitor in the State are subjected to a routine inspection at least once each year. These routine inspections are scheduled on a cyclical basis, although adjustments are made in order to suit the Inspectors convenience. Each new practice is inspected approximately six months after its establishment Routine inspections involve a pre-arranged visit by one of the Trust Account Inspectors, in the course of which he or she conducts an inspection in accordance with a check-list issued by the society. The check-list is concerned primarily with the statutory requirements relating to the handling and recording of trust moneys, especially those relating to the types of accounting records which must be kept, the form in which they must be kept, and the need for them to be kept accurately. For these purposes it requires inspectors to make physical examinations of the records and to conduct certain sample checks of procedures and arithmetical calculations. It also, however, requires inspectors to enquire about certain procedures (for example, relating to the signing of cheques) which are not required by statute but are considered desirable by the Society, and to do sample checks for particular types of entries (such as trust journal entries) "towards the end of [the] month that are subsequently] reversed", or transactions (such as financial transactions between solicitor and client), which the Society considers worthy of special attention In these instances, the inspectors are expected to make certain investigations into the propriety of any such entries or transactions as occur in the chosen sample. The great majority of routine inspections are completed within one day. We understand that the Law Society is currently revising its check- list for inspectors with a view to making routine inspections more rigorous.

7.6 Special inspections are conducted where the Law Society has information causing it to suspect that a particular solicitor may not be handling or recording trust moneys in the correct manner. The information may come from routine inspections, complaints by clients, or other sources. There are no specific rules or guidelines for special inspections, but they are usually considerably more rigorous than routine inspections.

7.7 The Society is now conducting routine inspections at a rate of approximately 2000 per year, which is almost sufficient to cover each of the 2300 or so practices in the State.[9] The number of special inspections fluctuates somewhat, but in recent years it has exceeded 200 per annum. During the year ending 30th June 1984, there was a total of 636 reports by Inspectors disclosing alleged breaches of statutory requirements. Five of these reports led subsequently to the institution of disciplinary action or criminal proceedings against the solicitor concerned, and in a further 150 cases the Law Society sent letters to the solicitors solicitors demanding an explanation of certain matters.

7.8 The following table lists the means by which defalcations during the four years to 30th June 1984 were discovered by the Law Society.[10]

Initial Source of Information	*Number of Instances*
Law Society	
- routine	42
- special	Nil
Client	22
The defaulting lawyer	4
Partner or former partner	3
Employer	2
Employee	1
Other	5
Total	**79**

It is clear that routine inspections are now the most common means by which defalcations are detected. On the other hand, a number of defalcations have remained undetected by one or more routine inspections of the accounts in question but have been discovered subsequently by other means.

7.9 In conclusion, mention should be made of the substantial changes which have occurred in the Law Society's inspection activities since we began our Legal Profession Inquiry. In 1976 the society had four Trust Account Inspectors who conducted 330 routine inspections, and estimated the cost of its inspection activities as $25,000.[11] In 1984 it had 12 Inspectors who conducted 2000 routine inspections, and spent $380,000 on inspection activities.

B. Investigations

7.10 The Law Society has statutory power to appoint a solicitor or accountant or one of its own employees, "to investigate any accounts, transactions and affairs" of a specified solicitor and to provide it with a "confidential report as to any irregularity or professional misconduct" that may be disclosed or should be further investigated.[12] The appointment is subject, however, to approval by the Prothonotary, a senior officer of the Supreme Court.[13] The statutory provisions about forwarding copies of reports to the Law Society and the Attorney General, and the preservation of due confidentiality in relation to an investigatior's work, are similar to those concerning Inspectors.[14]

7.11 Investigators appointed in this way have the same powers of investigation as Inspectors, save that they may require information in relation to the "accounts, transactions and affairs" of the solicitor in question rather than only in relation to the trust accounts.[15] There is a specific provision which makes it an offence, and professional misconduct to fail to provide information required by an Investigator or to hinder or delay an Investigator in the performance of his or her duties.[16]

7.12 A further difference between the statutory provisions relating to Investigators and Inspectors respectively is that the former provide that, unless the Investigator reports no irregularity or professional misconduct, the Law Society can require the solicitor in question to meet the costs of the investigation.[17]

7.13 During the three years to 30th June 1984 the Society appointed an Investigator on 54 occasions.[18] Appointments have been made from a number of different firms of accountants. It is rare for an investigation to be conducted other than where there is already compelling evidence of serious irregularities (usually involving defalcations) concerning trust moneys. The purpose of investigations, therefore, is usually to determine the precise nature and extent of irregularities and defalcations rather than to be a means of primary detection.

7.14 There are no rules or guidelines about the way in which these investigations are to be conducted, other than those to which we have referred already. They usually involve a very thorough examination of the solicitors' trust accounts and sometimes take months to complete. During the year to 30th June 1984, a total of twelve reports were made by Investigators, nine of which have led to disciplinary action and/or criminal proceedings and two others remain under consideration.[19]

7.15 In the three years to 30th June 1984, the total cost of investigations conducted at the request of the Law Society was approximately $314,000.[20] About $72,000 of this amount was recovered from the solicitors under investigation.

III. ACCOUNTANTS' EXAMINATIONS

7.16 Solicitors in New South Wales must keep their trust account records "In such a manner as to disclose the true position in regard [to trust moneys received by them] and to enable the accounts to be conveniently and properly audited".[21] They are not, however, required to have the accounts audited. Instead, their trust accounts must be subjected each year to an examination less rigorous than an audit, conducted by a registered public accountant of their choice.[22] There is an exemption for solicitors who certify to the Law Society that they have not received, held or disbursed" any trust moneys during the year in question.[23]

7.17 The accountant must provide the solicitor with a report on his or her examination and the solicitor must then submit that report when applying to the Law Society for an annual practising certificate.[24] If no such report is submitted, the solicitor will not be granted a certificate and accordingly will not be entitled to practise as a solicitor.

7.18 The only statutory requirements about the type of examination that the accountant must undertake are contained in the prescribed form of report which he or she must submit.[25] The current form is reproduced in full in Appendix II of this Report, but its principal features are that the accountant must state that he or she

has inspected the trust account records produced by the solicitor as those relating to transactions during the preceding year to 31st March;

is of opinion that these records "are of the nature and in the form" prescribed by the Solicitors Trust Account Regulations and "appear to have been regularly written up and properly kept";

has seen cash books containing what "purports to be [an end-of-year] reconciliation" of the balance in those books with the balance in the bank pass books or sheets, and has ascertained that the balance in the latter books or sheets agrees with that shown in the reconciliation statement;

has seen what "purport to be trial balance statements" at the end of each quarter and are in the prescribed form, and has ascertained that the trial balance statement for the last quarter agrees with the end-of-year reconciliation statement referred to above;

has ascertained that there are no debit balances in any of the quarterly trial balance statements "other than those which have been satisfactorily explained" to him or her and

has examined "the additions of not less than ten accounts in the trust ledger' and ascertained that the end-of-year balance in each of them agrees with that shown in the end-of-year trial balance statement.

The report must also deal with the solicitor s obligation to make the "statutory deposit" to which we referred earlier.[26] If the accountant is "unable to report" in the terms outlined above "except with qualifications", the qualifications must be stated in the report.[27]

7.19 Accountants conducting these examinations have no statutory powers to require information or to examine records other than the trust account records, such as the general account or the office files. On the other hand, if an accountant considers that he or she has insufficient information to make the required report without qualifications, that opinion can be expressed in the report.

7.20 UponreceivingthereportofanaccountanfsexaminatiomtheLawSocietyhaspowerto require the solicitor to provide a report by a second accountant, whom the Society may nominate.[28] The Society must pay the cost of the report unless it discloses that the solicitor has failed to comply with the relevant statutory requirements.

7.21 During the three years to 30th June 1984, more than 12,000 reports were submitted by accountants to the Law Society. Some 562 of these were qualified in some way (excluding those qualified only in relation to the "statutory deposit" requirements).[29] In none of the cases where qualified reports were received did the Society require a further report or a report by another accountant None of the qualified reports led to the Law Society refusing to grant a practising certificate, or gave rise to other disciplinary action.

7.22 We listed earlier in this chapter the means by which the Law Society became aware of the 79 defalcations discovered by it during the four years to 30th June 1984.[30] As indicated there, none of these were discovered as a result of accountants' examinations.

FOOTNOTES

1. Legal Practitioners Act 1898, s.42(3).

2. *Id*., s.42(8).

3. *Id*., s.42(5).

4. *Id*., s.42(5A) and (9).

5. *Id*., s.42(10).

6. *Id*., s.42(11)-(15).

7. Eleven are full-time, and one is part-time.

8. This category has often been referred to in the past as random inspections. and is now referred to by the Law Society as" normal" inspections.

9. Statistical information in this paragraph and succeeding paragraphs has been provided by the Law Society at the request of the Commission.

10. See note 7.7.1 above.

11. See note 7.7.1 above.

12. Legal Practitioners Act, 1898, s.82A(1).

13. *Id*., s.82A(4).

14. *Id*., s.82A (2), (2A), (7)-(11).

15. *Id*., s.82A(5).

16. *Id*., s.82A(6).

17. *Id*., s.82A(3).

18. Statistical information in this and succeeding paragraphs has been supplied by the Law Society at the request of the Commission.

19. See note 7.13.1. The remaining report related to a solicitor who subsequently died before consideration of disciplinary action had been finalised.

20. See note 7.13.1.

21. Legal Practitioners Act 1898, s.42(2).

22. Solicitors Trust Account Regulations, reg.8.

23. *Id*., reg.8(4).

24. *Id*., reg.8(3).

25. *Id*., Form No.l.

26. See para.2.5 above.

27. Solicitors Trust Account Regulations, Form 1, para.2.

28. *Id*., reg.8(5).

29. Statistical information in this and the next paragraph has been supplied by the Law Society at the request of the Commission.

30. See para.7.8 above.

8. Independent Scrutiny: Society Inspections and Investigations

I. INTRODUCTION

8.1 The present system of Law Society inspections and investigations has been outlined in the previous chapter. No substantial concern has been expressed to us about the system for conducting investigations, nor have we seen any cause for such concern. Accordingly, we concentrate in this chapter on the conduct of inspections, especially routine inspections. We do so under the following headings:

- merits of the present system;
- other considerations;
- possibilities for reform; and
- recommendations.

Some ancillary issues relating to inspections are considered in chapter 10.

II. MERITS OF THE PRESENT SYSTEM

8.2 The present system of Trust Account Inspectors, employed by the Law Society and engaged largely in conducting a routine inspection of each practice every year, provides substantial benefits for both the public and the profession By specialising solely in the area of solicitors trust accounts, Trust Account Inspectors are likely to become substantially more skilled than most other accountants in advising solicitors about the operation of such accounts and detecting irregularities or undesirable methods. Few accountants in private practice have acquired extensive experience or expertise in the area. Examination of solicitors trust accounts is different in many respects from most other types of work undertaken by accountants, including, for example, company audits.[1] In the absence of comparable specialised experience, accountants are more likely to miss irregularities in the accounts, especially if the required examination is brief or the solicitor is adept at concealing the true state of affairs.

8.3 The fact that the inspectors are employed full-time by the Law Society makes it easier to ensure satisfactory levels of ability and performance than is possible in relation to a wide range of accountants in private practice chosen by the solicitors whose accounts they are to examine. The greater ease and speed of communication with a small team of Inspectors helps the Law Society to identify problems being experienced in the field, to initiate special checks of problem areas by, for example, changing its check-list for Inspectors or the frequency with which certain types of practices are inspected, and to develop and implement programs for advising and educating solicitors in trust account techniques. The Society has availed itself of these opportunities to a significant extent, at least in recent years.

8.4 The maintenance of due independence from the solicitor being examined is less likely to be at risk where the examination is conducted by an Inspector chosen and employed by the Law Society, rather than by an accountant who is engaged and paid by the solicitor. For example, in the former situation, there is no danger that, in order to attract and retain business, the examination may be conducted in a cursory fashion so that low fees can be charged, a reputation for being “difficult” can be avoided, and thus accounting business can be attracted and retained.

8.5 Although there is no conclusive evidence on the point, it seems reasonable to conclude that a system of examinations of a given rigour into all solicitors in the State can be conducted more economically by a team of Inspectors than by a wide range of accountants in private practice. The available economies lie largely in the development of specialised skills and in the opportunities for more efficient and rationalised allocation of resources. For example, one Inspector can be allocated to inspect all practices in a particular country town or region during one journey.

8.6 A point of considerable significance is that, as mentioned earlier, more than half of the 79 defalcations discovered in the last four years have been discovered by the Law Society’s own Inspectors.[2] By contrast, for example, none have been reported to the Society as a result of accountants examinations.

III. OTHER CONSIDERATIONS

8.7 A number of solicitors to whom we have spoken in recent years have said that from their experience, routine inspections tend to be concerned largely with formalities and arithmetical accuracy rather than constituting a more penetrating examination of the accounts. Certainly, as mentioned earlier, there have been instances of defalcations or substantial irregularities going undetected by one or more routine inspections of the accounts in question and the fact that the great majority of such inspections are completed within a day may raise questions about their rigour. Also, it is common f or an inspection to be conducted by an Inspector who has not previously inspected the practice in question and lacks familiarity with its records and general manner of operation Indeed, the Law Society’s current policy is that firms should not be inspected by the same Inspector in successive years. By contrast, the practice may be examined by the same accountant for many years.

8.8 On the other hand, the check-list for Inspectors has been improved since some of the above-mentioned criticisms were expressed to us and is undergoing further revisions at present There can be little doubt that, given the present nature of that list and the specialised skills and independence of the Inspectors, routine inspections are likely to be more rigorous than many accountants’ examinations, at least in relation to small practices. In large practices, however, the complexity of the Organisation and its accounts, and the greater financial resources, often mean that accountants are engaged to conduct very comprehensive examinations which may be much more thorough than a routine inspection of the same practice by a Law Society Inspector.

8.9 The following table shows the substantial expansion of the Law Society’s inspection activities in recent years, and the levels of defalcation over the same period.[3]

	No. of Inspectors employed by the Law Society	Estimated Cost of Inspectors	Compensation paid by Fidelity Fund for loss of trust moneys
1976	4	$25,000	$1.2m
1978	6	$80,000	$1.4m
1980	8	$137,000	$4.4m
1982	7	$289,907	$1.6m
1984	12	$380,000	$2.9m

There is room for considerable debate about the significance of these figures. On the one hand, it may be argued that the absence of a significant decline in the level of defalcation indicates that the expansion of inspection activities has been of little value. On the other hand, it may be argued that the expansion probably prevented an even worse incidence of defalcation. Moreover, the benefits of greater expenditure on Inspectors, and of improved inspection techniques, may take considerable time to flow through and indeed may uncover more defalcations and therefore erroneously appear to be increasing, or at least not decreasing, the incidence of defalcation.

8.10 It is important to bear in mind when considering possible reforms in this area that one option, whether in addition to or instead of changing the inspection system, is to require accountants examinations to be more rigorous than at present. We look at this option in detail in the next chapter and point out that in most other parts of Australia a more penetrating and thorough examination is required and certain rules have been made to enhance accountants independence from the solicitors whose accounts they are examining.

8.11 A further consideration relevant to the quality of routine inspections is the difficulty of attracting good applicants for Inspectors' positions, and of retaining for substantial periods the services of those who are appointed. This difficulty has been, and is continuing to be, experienced by the Law Society of New South Wales and its counterparts elsewhere. The work of an Inspector is highly specialised in an area in which other prospects are limited, involves a considerable amount of repetition and travel which many people would find unappealing, and is not very highly remunerated.

8.12 We suggested earlier that in one sense it may be more economical to use Inspectors, rather than a wide range of accountants in private practice, to scrutinise trust accounts on a State-wide basis.[4] But it should be noted that under present arrangements more than half of the cost of the team of Inspectors is met from interest earned on clients trust money[5] and the remainder is met by solicitors compulsory contributions, whereas accountants' examinations are paid for entirely by solicitors. Of course, solicitors' expenditure may be passed on by them through the fees which they charge clients.

8.13 Two further points about the present efficacy of inspectors merit consideration. First Inspectors, unlike Investigators but like accountants conducting examinations, lack statutory power to insist on examining records

other than trust accounts, such as general accounts and office files.[6] Secondly, there is currently no significant degree of contact between the Inspector responsible for inspecting the accounts of a particular practice and the accountant responsible for examining them. The development of such contact would be likely to improve the quality and efficiency of both the inspection and the examination as well as giving Inspectors (and through them the Law Society) valuable opportunities to assess the calibre of accountants examinations.

IV. POSSIBILITIES FOR REFORM

8.14 A number of possible reforms in the present system of Inspectors and routine inspections can be identified by looking at other jurisdictions. One possibility is to abolish the system of accountants examinations and rely principally or solely on inspections by Law Society Inspectors. Eventual adoption of this approach was under consideration several years ago in Queensland.[7] Another possibility is to retain the present system of routine inspections and to increase the rigour and frequency of accountants examinations. This could produce a degree of supervision more akin to the present system in Queensland, where each practice must undergo four thorough accountants examinations each year.[8]

8.15 A third possibility is to have fewer, more rigorous inspections, and to require accountants examinations to be more thorough. This would be somewhat akin to the position in Victoria, where inspections are conducted jointly by two Inspectors and usually take about two days, and each practice is inspected about every three years. A fourth possibility is to make little use of inspections but require accountants' examinations to be more thorough. This is broadly the approach adopted in England.[10] The nature of the accountants' examinations in these and other jurisdictions is described in greater detail in the next chapter.

8.16 In our Discussion Paper we made no suggestions for change in the frequency or thoroughness of routine inspections (save that sole practitioners should be inspected at least once each year),[11] but we did suggest that accountants examinations should have to be sufficient to constitute an audit, and thus be much more rigorous than is currently required. Since we published our Paper the Law Society has increased the thoroughness and frequency of its routine inspections and has developed proposals for an accountants examination which would be more thorough but would not constitute an audit. Our suggestions in the Paper in relation to accountants examinations, and responses which they elicited, are discussed in the next two chapters.

8.17 We suggested in our Discussion Paper that Inspectors should have the same powers as Investigators to examine solicitors accounts and files in addition to their trust account records.[12] The Law Society[13] has said that it has "no objection to our suggestion, and the Joint Legislation Review Committee of the two principal associations of accountants positively agrees with the suggestion.[14]

8.18 We also suggested that Inspectors and Investigators should be entitled to examine "the audit programme, working papers and other documents used or prepared" by an accountant examining a solicitor s trust account, and to "confer" with the accountant in relation to his or her examination.[15] This suggestion was based on a provision in South Australia.[16] The Law Society[17] and the Joint Legislation Review Committee[18] have expressed the same views about this suggestion as about the one referred to in the previous paragraph.

8.19 A number of changes could be made in relation to the specific types of check which Inspectors and Investigators are required, or at least empowered, to make. For example, they could be required to check a random sample of transfers from the trust account to the general account in respect of costs, in order to ascertain whether the correct procedures have been followed. We look at specific checks of this and other kinds in chapter 10.

V. RECOMMENDATIONS

8.20 The Law Society has made, and is continuing to make, significant improvements in its system of routine inspections of solicitors' trust accounts by its own Trust Account Inspectors. We believe that this system has a vital part to play in the prevention and detection of trust account irregularities, especially because of the opportunities which it provides for highly specialised, economical and coordinated scrutiny of the profession's trust accounts, and for an emphasis on education and prevention Law Society inspections have been the principal source of detection of defalcations in recent years.

8.21 We do not consider however, that it would be appropriate for us to recommend further major changes in the inspection system at this juncture. Our reasons may be summarised as follows. First, the inspection system has already been developed as much, or further, than in any other jurisdiction yet there is no appreciable evidence of a decline in the incidence of defalcations. Before devoting substantially increased resources to the system, it would be preferable to consolidate and refine the changes introduced in recent years and wait a few more years to see whether benefits flow through in the form of substantially reduced defalcations.

8.22 Secondly, and by the same token it is too early to conclude that the recent changes will not justify the resources devoted to them. Indeed, although there is a lack of hard proof, we believe that the changes have been generally worthwhile. Thirdly, there are considerable practical difficulties involved in seeking sufficient funds, and an appropriate calibre of well-remunerated recruits, for a substantially expanded system of Inspectors and inspections. Fourthly, for reasons discussed in the next two chapters, we believe that the present system of accountants examinations in this State is patently inadequate, and worse than in any other Australian jurisdiction We believe that the major emphasis in the near future should be on reform of these examinations rather than of inspections.

8.23 Accordingly, **we recommend that the Law Society should ensure that it achieves within the next year its recently stated objective of inspecting every practice in the State once each year, and should maintain that frequency of inspection thereafter. The Society should ensure that this increased frequency is accompanied by further refinement of inspection techniques.** Implementation of these recommendations may involve the employment of additional Trust Account Inspectors. A number of specific techniques which Inspectors could be required or empowered to employ are the subject of discussion and recommendations in chapter 10.

8.24 In order to enable Inspectors to trace and analyse effectively the manner in which trust moneys have been handled and recorded, **we recommend that Inspectors should have the same extensive powers as Investigators now have to require solicitors to provide documents (such as office files and general accounts) and other information which relates to the solicitor's practice**. For similar purposes, and to encourage fruitful liaison and co-ordination between Inspectors and accountants conducting examinations of the same practices, **we recommend that Inspectors should have access to any check-fist, audit program, working papers and other documents used by the accountant responsible for examining a particular**

practice's trust accounts, and should be expressly entitled to confer with the accountant. Inspectors should be entitled and encouraged to show their reports on a particular practice to the accountant responsible for examining that practice, but they should not be *required* to do so because in some instances the disclosure might hamper prevention or detection.

8.25 We have referred earlier to the high incidence of defalcations amongst sole practitioners.[19] In our view, this serious problem calls for special attention and, accordingly, we recommend that, at least during the next few years, the Law Society should inspect sole practices more frequently than other practices and/or ensure that inspections of sole practices are particularly thorough.

FOOTNOTES

1. See further discussion of this point in Chapter 9.

2. See para.7.8 above

3. Information supplied by the Law Society at the request of the Commission.

4. See para.8.5 above.

5. See paras.2.4 and 2.10 above.

6. See paras.7.2, 7.11 above.

7. See "Address of Retiring President, Mr. G.A. Murphy, *Queensland Law Society Journal* (1980), vol. 10, p.241, at p.242, where it was described as "the ultimate objective (and this is very long term)" of the Queensland Law Society.

8. See chapter 9 below, esp. para.9.48

9. See chapter 9 below, esp. paras.9.41, 9.4 3, 9,49.

10. See Solicitors Act 1974 and Accountants Report Rules 1975.

11. See Discussion Paper. paras.6.24-6.34 and 7.1.

12. Discussion Paper, para.6.32.

13. Law Society's Response, para.4.3

14. Joint Committee Reply, para.4.

15. Discussion Paper, para.6.32

16. Legal Practitioners Act 1981, s.34(1).

17. Law Society's Response, para.4.1

18. Joint Committee Reply, para.4.

19. See para.2.25 above.

9. Independent Scrutiny: Accountant's Examinations

I. INTRODUCTION

9.1 We outlined in chapter 7 the present system of accountants' examinations in New South Wales. In this chapter we concentrate our discussion and recommendations on one central issue, namely, whether these examinations should have to be more rigorous than is currently required. Other issues relating to examinations are considered in chapter 10.

9.2 When considering this central issue, one of the most controversial and important questions is whether the examination should be required to constitute an audit. Accordingly, much of this chapter is concerned with the nature, objectives and efficacy of audits. But we do not regard the basic issue as being a choice between examinations and audits; indeed, we regard an audit as a type of examination Moreover, the currently required type of examination could be made substantially more rigorous without being required to constitute an audit In fact it could be made more rigorous than some types of examination which are described as audits.

9.3 We begin by discussing the general question: should examinations have to be more rigorous? We then look at a number of ways in which greater rigour could be achieved. The chapter concludes with a series of recommendations arising out of the preceding discussion.

II. SHOULD EXAMINATIONS HAVE TO BE MORE RIGOROUS?

A. Criticisms of the Present Examination

9.4 Criticism of the present examination requirements has been voiced from a number of sources within both the legal and accounting professions. For example, the Auditor General of New South Wales, Mr. Jack O'Donnell has referred to

> "the prime defect that although there is a requirement to keep accounts in such a manner that they may conveniently be audited, there is no requirement that the accounts be audited. The checks stipulated when an accountant is called in to provide the annual certificate can in no way be regarded as an audit. They are completely inadequate to reveal any wrongdoing. Perhaps they cause an even greater evil. The uninformed public, knowing that an accountant has access to the books, are likely to assume, wrongly, that their interests are being safeguarded by an audit. This could lead them to forsake elementary checks on their solicitors' handling of their affairs which business prudence would otherwise induce."[1]

Mr. O'Donnell added that the Public Accountants Registration Board, of which he is Chairman "is not happy with the situation."[2]

9.5 The Accounting Research Centre of the University of Sydney has expressed the view that if the examination requirements are

> "intended to provide protection to the clients of solicitors in relation to [trust moneys, they] can only be described as grossly inadequate".[3]

The Centre's criticisms included the lack of any requirement that the accountant check that the Solicitors Trust Account Regulations have been complied with and "form an opinion whether all trust funds have been properly accounted for."[4] The Centre also emphasised that the required examination does not constitute an audit. Instead, it is

> "only the most cursory examination of a very limited number of matters.... Accountants appear to recognise the fact that an audit is not required, and that the Professional Auditing Standards do not apply".[5]

We return later to a discussion of the nature of an audit, and of the Auditing Standards referred to by the Centre.[6]

9.6 Coopers and Lybrand, a leading firm of accountants, has made detailed criticisms of the wording of the report which accountants are required to submit.[7] In summary, they criticise the vagueness and superficiality of the requirements, especially the general failure to require accountants to look behind documents in order to check whether they have been prepared property." Essentially," they say

> "the provisions are deficient because they relate mainly to peripheral matter and they avoid the one fundamental issue, that is, the need to ensure that all trust moneys have been properly accounted for in accordance with the regulations. Plainly the present regulations neither require nor enable the accountant to report that trust moneys are properly accounted for. As matters stand, the reporting accountant is neither required nor able to examine records other than those relating to trust moneys; and he has no access to the solicitors files. Without full access to all records it is not possible for the accountant to express the required opinion".[8]

9.7 A number of solicitors have indicated to us that they do not consider the present examination requirements to be sufficient Some of these favour the introduction of compulsory audits. Both the Law Society and the Joint Legislation Review Committee of the principal associations of accountants in New South Wales (hereafter referred to as the Joint Committee) have agreed that the present examination requirements "do not in themselves provide adequate protection against dishonesty or incompetence" by solicitors in the handling of trust moneys.[9] The Law Society has proposed more thorough inspections by its inspectors[10] and is considering introduction of "more rigorous and demanding" accountants' examinations.[11] The Joint Committee agrees with the Society in relation to inspectors[12] but also has supported proposals for the introduction of compulsory audits in place of the

current accountants examinations, provided that the accountants conducting the audit have unrestricted access to all accounting records and related information".[13]

9.8 In practice, it is clear that accountants' examinations often go further than is required by law. At our request, the Accounting Research Centre carried out in 1979 a survey of chartered accountants in New South Wales.[14] Between them, the respondents had carried out some 946 examinations of solicitors' trust accounts in the previous year.[15] The following table indicates the number of these examinations which the accountants described as going beyond the statutory requirements.[16]

Size of Solicitors Practice being Examined	**Number and Percentage of Examinations which exceeded Statutory Requirements**
Sole Practice	181 - (56%)
2-3 Partners	165 - (46%)
4-9 Partners	156 - (69%)
10 or more Partners	43 - (97%)
Total	**545 - (56%)**

The survey indicated that in some instances the requirements were exceeded at the request of the solicitors in question, but it appears that in many other instances the decision to do so was made by the accountant.[17] The most common types of additional work were sampling trust account receipts, checking the internal control system, examining the general accounts, and checking authorities for withdrawals.[18]

9.9 A number of criticisms about the present system of accountants' examinations relate to matters other than the general nature of the examination. For example, it is asserted that the examination should include additional specific requirements (such as contact with clients to check the accuracy of trust account records relating to them) or that measures should be taken to improve the independence and expertise of accountants undertaking the examinations. These criticisms are considered in the next chapter.

B. The Nature and Scope of an Audit

9.10 Reference has been made in preceding paragraphs to the concept of audits. The following comments on the nature and scope of audits are taken from a report commissioned by us from Coopers and Lybrand:

"Audits may be classified as (a) statutory audits, e.g. those required under the Companies Act; or (b) extra-statutory audits, e.g. those required by agreements between parties. The nature and scope of the examinations to be carried out both in statutory audits and non-statutory audits are determined by the specific or implied terms of the engagement [between auditor and client], often dictated by the form of report required from the auditors...

Under the Companies Act, auditors are required to express an opinion primarily, on the truth and fairness of annual accounts [balance sheets, profit and loss statements and related notes] of companies.... Other types of audit reports are [however,] often required both by a statute and by contract..

Although the term "audit' is loosely applied to all examinations by auditors, this [report] confines the term to an examination free of restrictions, carried out by an independent registered public accountant Here, " free of restrictions" means that no restrictions are imposed by the terms of the engagement on the work to be done by the auditor for the purpose of his report.... Auditing is concerned with verification the examination of financial data for the purposes of Judging the faithfulness with which they portray events and conditions."[19]

9.11 For many years, audits involved the detailed examination of every record of each transaction not only in the accounts but also in files and other documents. Nowadays the emphasis is on an examination of the accounting and financial control systems being used, rather than of every transaction. This involves the auditor making a professional judgment on the appropriate steps to be taken in relation to the particular organisation and accounts being audited. In 1980 the International Federation of Accountants made the following statements about the nature and scope of audits:

"The auditor assesses the reliability and sufficiency of the information contained in the underlying accounting records and other source data by:

(a) making a study and evaluation of accounting systems and internal controls on which he wishes to rely and testing those internal controls to determine the nature, extent and timing of other auditing procedures, and

(b) carrying out such other tests, inquiries and other verification procedures of accounting transactions and account balances as he considers appropriate in the particular circumstances.

The auditor determines whether the relevant information is properly communicated by:

(a) comparing the financial statements with the underlying accounting records and other source data to see whether they properly summarize the transactions and events recorded therein, and

(b) considering the judgments that management has made in preparing the financial statements; accordingly, the auditor assesses the selection and consistent application of accounting policies, the manner in which the information has been classified, and the adequacy of disclosure.

> Judgement permeates the auditor's work; for example, in deciding the extent of audit procedures and in assessing the reasonableness of the judgements and estimates made by management in preparing the financial statements. Furthermore, much of the evidence available to auditors is persuasive rather than conclusive in nature. Because of the above factors absolute certainty in auditing is rarely attainable."[20]

9.12 The term "audit", then, is not a precise term of art connoting a specific and exhaustive set of steps which must be taken in the examination and a specific list of matters which must be dealt with in the report. On the other hand, the term does have a substantial number of general and specific connotations for accountants, even though in some instances there may be disagreement amongst accountants over certain issues. Particular mention should be made here of the *Statement of Auditing Standards*[21] *and Statements of Auditing Practice*[22] which have been drawn up and published by the two principal associations of accountants in Australia. The *Standards* are described by the association as "the basic principles which govern the auditor s professional responsibilities and which must be compiled with whenever an audit is carried out".[23] Failure to observe the Standards will be regarded by the two associations as grounds for disciplinary action.[24] The Standards apply "to audits generally" rather than only to company audits.[25] The *Statement of Standards* is supplemented by *Statements of Auditing Practice* which are concerned with "the procedures by which the *Standards* may be applied".[26] These *Statements* "provide authoritative guidance" and if accountants "find it necessary to significantly depart from [them], they must include in their working papers details of the departure and their reasons."[27]

9.13 The current Standards comprise twenty five paragraphs dealing with matters such as the scope of an audit, confidentiality, independence, planning, documentation and reporting.[28] The *Statements of Auditing Practice,* of which there are nineteen at present, are considerably more detailed than the *Standards.* They cover topics such as controlling the quality of audits, audit evidence, planning, documentation fraud and error, and auditing of computerised accounts.[29]

9.14 In addition to these official *Standards and Statements,* there is, or course, a very substantial body of literature (and some case law)[30] on the duties and techniques involved in conducting an audit, and a considerable amount of unwritten custom and lore on these topics amongst accountants. Nevertheless, where statutes require "an audit" to be conducted, they commonly add certain general and/or specific statements about the nature of the required examination For example, as we have mentioned, the Companies (New South Wales) Code requires auditors to express an opinion on whether certain accounts are " properly drawn up... so as to give a true and fair view" of certain specified matters[31], and to report any "deficiency, failure or shortcoming" in relation to certain specified matters (such as the adequacy of returns received from branch offices").[32]

9.15 The application of general auditing principles to an examination of solicitors' trust accounts would result in differing types of examination for different practices. Relevant factors would include the size of the practice, the types of work which it undertakes, its internal control systems, and its general office systems. Factors such as these could affect, for example, the nature and extent of the testing and sampling undertaken. The size of a practice is of special relevance because in smaller practices it is difficult-if not impossible, to have internal control systems which prevent or greatly inhibit incompetence or dishonesty by a principal in the firm. Accordingly, it may be necessary to place greater emphasis on examining transactions, rather than systems, when auditing these practices.

C. Audits and the Detection of Fraud

9.16 One aspect of the nature of an audit about which some confusion has arisen is the extent, if any, to which it must be directed towards discovering frauds or defalcations. There is no doubt that audits cannot be expected to detect all frauds or defalcations. But that does not necessarily mean that such detection is not, or should not be, their primary purpose or one of their principal purposes. It is quite possible, of course, that the purposes should differ substantially according to the type of audit being undertaken. We have pointed out earlier that there is no precisely-defined standard form which an audit must take. For example, company audits may be concerned more with matters such as fair calculation and presentation of asset values and operating profits, than with detection of fraud by a director or employee. Also, the proper purposes may be determined, or at least affected, by specific statutory requirements.

9.17 In Victoria, solicitors' trust accounts must be subjected to "an audit, made in accordance with" certain statutory rules.[33] The Dawson Committee, established by the Victorian Government to enquire into the regulation of solicitors' trust accounts and certain related matters, reported in 1977 that in its view

> "it is clear from the solicitors trust account rules that a primary aim of an audit of [such] accounts is the discovery of any illegality or irregularity and that its concept and philosophy are different from those of a commercial audit."[34]

9.18 It should be noted that the question of detecting "fraud or error" is dealt with in a *Statement of Auditing Practice.* The Statement is directed principally towards company audits. It says, amongst other things, that an

> "auditor should plan his audit so that he has a reasonable expectation of detecting material misstatements in the financial information resulting from fraud or error... Due to the inherent limitations of an audit... there is ability that material misstatements of the financial information resulting from fraud and, to a lesser extent, error may not be detected. The subsequent discovery of [such] material misstatement ... does not, in itself, indicate that the auditor has failed to adhere to the basic principles governing an audit.... The auditor should plan and perform his audit with an attitude of professional scepticism recognising that he may encounter conditions or events during his examination that would lead him to question whether fraud or error exist."[36]

9.19 In our Discussion Paper we said that

> "whatever may be the objectives of a commercial audit, we believe that the major objective of an audit of a solicitor's trust account is the detection of frauds, defalcations, allegations and irregularities."[37]

In its response to our Paper, the Joint Committee of accountants said that it wished

> "to point out in the strongest possible terms that auditors cannot be expected and no accountant would be willing to report that he is of the opinion that no fraud or defalcation has taken place. However, the [two associations of accountants] acknowledge the strong deterrent effect of an audit requirements."[38]

It should be noted that we did not suggest a requirement of the kind criticised by the Committee.

9.20 The Auditor-General, Mr. O'Donnell, has expressed concern about the Committee's views quoted in the previous paragraph.[39] He said in part:

> "I acknowledge that an auditor cannot be expected to uncover every minor or well-contrived fraud. However, I must repeat my very strong view that an accountant who does not undertake the task with an awareness of the risk of fraud and set as his objective the detection of it, himself is misrepresenting his services to the general public."[40]

He added that he endorsed "whole hearted the comment in our Discussion Paper which we have quoted above.[41] Mr. O'Donnell made these comments in the context of solicitors' trust accounts but also expressed the view about audits generally that "there is still a strong community expectation that an audit is some form of protection against or discovery of fraud".[42]

9.21 In conclusion it should be pointed out that, whether or not an audit concentrates on prevention or detection of fraud, it may further these goals indirectly by preventing or detecting incompetence or negligence which otherwise might have given rise eventually to dishonesty. As a committee of lawyers and accountants in Victoria has pointed out,

> "experience over many years confirms that the solicitor who starts with the deliberate intention of stealing his client s moneys is extremely rare. Even those who are finally dishonest usually commence with muddling and poor accountancy".[43]

Our investigations indicate that this statement is true also of New South Wales.

D. Considerations of Cost

9.22 One of the most important matters to be borne in mind when considering whether the present accountants examination should be made more rigorous is, of course, the increased cost which would be involved. It is, however, very difficult to develop accurate estimates of the cost of any such reform. Much depends on the precise nature of the new requirements, the type of solicitors practice being examined, the type of accountants' practice conducting the examination the relationship between the two practices, and other factors.

9.23 As mentioned earlier, in 1979 the Accounting Research Centre conducted at our request, a survey of chartered accountants in New South Wales.[44] Amongst other questions, the accountants were asked about the fees which they would charge for carrying out the kind of examination of solicitors' trust accounts currently

required by statute, and the fees which they estimated they would charge if conducting a more extensive examination of a kind described in the questionnaire. The latter examination was described as whatever would be deemed by the accountant to be necessary in order to be able to prepare an "audit report" stating whether

> " in my opinion based on my examination of the records produced to me by the solicitor and on the explanations and information given to me in response to the inquiries which I considered it necessary to make -
>
> (a) the solicitor complied with.. section 41(1) of the Legal Practitioners Act; and
>
> (b) the solicitor kept accounts of all trust moneys in such a manner as to comply with ... section 42 (2) of that Act and ... the Solicitors' Trust Account Regulations."[45]

9.24 The Centre also conducted a survey of accountants in Queensland, and asked, amongst other questions, about their fees for conducting the kind of examination currently required in that State, which is defined generally by statute as an "audit" but is also required specifically to include certain types of test.[46]

9.25 In the light of the New South Wales survey, the Centre made a comparison between the fees which accountants would charge for the currently required examination, and the fees likely to be charged for an examination of the kind described in its questionnaire. The Centre found that for sole practitioners and firms with two or three partners the average fee being charged for accountants' examinations was in the order of $200.[47] For firms of four to nine partners the average cost was about $500, and for larger firms it was about $950.[48] The Centre said that these fees "would on average, more than double" if the hypothetical type of examination was required, and that the increase "would be greatest amongst small firms."[49] It said that the anticipated fees for such an examination "were not markedly different" from those which its survey of Queensland accountants found were being charged for the audit required in that State.[50]

9.26 The Law Society has expressed some reservations about the accuracy of this attempt at costing.[51] In particular, it has pointed out that no account was taken of the "value of the extra time of solicitors taken in complying with" the more rigorous requirements of the hypothetical examination described in the questionnaire.[52]

9.27 The Joint Committee of accountants has described the Centre's estimate of the increase in costs as very conservative.[53] The Committee emphasised the increased costs which might fall on sole practitioners, due to their inevitable lack of extensive systems for internal control. It said that for sole practitioners "the audit would need to be wider than for instance in a multi-partner firm, especially where accountants already prepared the partnership accounts or financial statements" for such a firm.[54]

9.28 There can be no doubt that a substantial increase in the rigour of the required accountants' examination would also involve a substantial increase in the fees charged for such an examination on the other hand, for many solicitors, especially those in medium-sized or large firms, there would not be so substantial an increase in the total fees paid for accountants' services. This is because, as the Accounting Research Centre's survey demonstrates, much of the work likely to be involved in a more rigorous examination is already being carried out

for some firms, whether or not at their request.[55] Also, systems of internal controls in larger firms are likely to minimize the amount of additional work considered necessary by the examining accountant to comply with the more rigorous statutory requirements. Moreover, all solicitors are already required to keep such records as are necessary to enable their accounts to be "conveniently and properly audited".[56] Indeed our inquiries suggest that a considerable proportion (albeit perhaps a minority) of practices already have their trust accounts audited.

9.29 A number of other considerations need to be taken into account on the question of cost. First, there appears to be a broad measure of agreement, even within the Law Society, that the accountants' examination requirements must be made more rigorous.[58] Proposals presently under consideration by the Law Society[59] seem likely to involve a substantial increase in costs, at least for those practices which currently go no further than the minimum type of examination required by statute.

9.30 Secondly, we have referred earlier to the very large amounts of trust money lost through defalcations in New South Wales.[60] Reimbursement of these losses, and attempts to prevent further losses, cost solicitors almost $2 million each year through their compulsory contributions to the Solicitors' Fidelity Fund, and an even larger cost is borne by the interest which is earned on clients' trust moneys but not paid to them. The level of defalcations is so serious that it weakens the profession's claim to retain existing monopolies (especially in the conveyancing area) and already has led to onerous and costly restrictions on solicitors' activities, notably in relation to borrowing from clients and operating private finance companies.[61]

9.31 Thirdly, lawyers in every other State are subjected to more rigorous accountants' examinations, with the consequential costs involved, than solicitors in New South Wales.[62] Yet it is this State that has the worst record of defalcations. Moreover, people such as travel agents and stockbrokers in this State have to undergo, and pay for, much more thorough examinations than do solicitors.[63]

9.32 Fourthly, the introduction of more thorough and extensive supervision of solicitors accounts is likely in many cases to improve the general efficiency of their practice. For example, there is considerable evidence that many solicitors, especially perhaps in small practices, lose money by failing to record work accurately and to render bills promptly, and waste time and money through keeping office files and trust ledger accounts open much longer than is necessary. These inefficiencies and costs are likely to be reduced by more effective outside scrutiny of trust accounts and related office systems.

E. Other Considerations

Confidentiality

9.33 Solicitors are required to observe strict standards of confidentiality in relation to the business and personal affairs of their clients. If solicitors were required to give accountants more information than is necessary for an accountants examination of the kind currently required, it may be argued that the confidentiality of clients' affairs is placed at undue risk. On the other hand, accountants already have access to highly sensitive material in solicitors' trust accounts, and in other aspects of accountants' practice (notably in relation to income tax returns) they commonly acquire information which their clients wish to remain confidential. Many solicitors already give accountants access to their office files and general accounts.

9.34 Accountants are well-versed in the need to preserve confidentiality and have formulated rules for that purpose, including rules relating specifically to auditing.[64] We know of no significant incidence of complaints about breach of confidentiality by accountants, whether in New South Wales or in jurisdictions where more extensive access to solicitors' records already occurs. The Law Society has stated its confidence that accountants are" as well able to respect.. confidentiality as solicitors", but says that the public would have to be advised that material "previously reposed solely in their solicitors would thenceforth be available in confidence also to auditors with whom the clients had no dealings or personal aquaintance".[65]

Law Society Inspections

9.35 We have referred earlier to the system of routine inspections by the Law Society's Trust Account Inspectors, and have discussed some of the strengths and weaknesses of those inspections by comparison with accountants' examinations, whether as currently required or of a more penetrating nature.[66] These considerations have led some people to argue that the primary emphasis in reform of the present arrangements for independent scrutiny should be placed on more thorough and frequent inspections. The Law Society has taken this general view, although it is also considering improvements to the accountants examination requirements.[67] Others, however, argue, amongst other things, that accountants' examinations could have substantial advantages over inspections in some respects, at least if made more rigorous and independent Some point out that the system of inspections has already been built up further in New South Wales than in any other State, yet the level of defalcations in this State remains the worst and shows no sign of significant improvement.

III. SOME POSSIBILITIES FOR REFORM

A. Introduction

9.36 We have referred earlier, when discussing Law Society inspections, to a number of ways in which the current mixture of on inspections and accountants' examinations could be altered.[68] Insofar as the examinations are concerned, these possibilities include making them substantially more rigorous, leaving them largely unchanged, or abolishing them. We know of no-one who favours a fourth possibility, namely making them less rigorous.

9.37 Two of the first three possibilities mentioned above, namely abolition and no change, require no further description here. But it is appropriate to outline here some ways in which the examination could be made more rigorous. In this section we look briefly at five such ways, namely

requiring the examination to constitute an audit;

requiring the accountant to express opinions on certain matters of a general nature (such as whether the statutory provisions relating to trust moneys and accounts have been complied with);

increasing the frequency of examinations;

giving the accountant access to the solicitors other accounts and files;

adding substantially to the number of specific types of check which must be undertaken as part of the examination

These measures are not, of course, mutually exclusive. As will appear from the following paragraphs, the principal possibilities under each of these heads can be identified largely by looking at the existing requirements in other Jurisdictions.

B. An Audit Requirement

9.38 One possibility is for the relevant statutory provisions to describe the required examination as an "audit". This is the approach adopted in Queensland[69], South Australia[70], Victoria[71], The Australian Capital Territory[72] and NewZealand.[73] It has also been adopted in New South Wales in relation to, for example, stockbrokers[74] and real estate agents.[75]

9.39 We have discussed earlier the nature and scope of audits.[76] It is clear that a requirement to conduct an audit would necessitate, and would be interpreted by accountants as necessitating, a much more rigorous examination than is currently required in New South Wales. Such a requirement, even if unaccompanied by more specific statutory requirements, brings with it a very substantial corpus of law, guidelines and customs in relation to auditing responsibilities and techniques. It would be impracticable to incorporate all or even most of this corpus in statutory provisions, but nevertheless it is of great significance and assistance to accountants. One way of emphasising its applicability would be to state specifically by statute, as has been done in Queensland,[77] that the audit must be made in compliance with the current Statement of Auditing Standards and the *Statements of Auditing Practice*.[78]

9.40 On the other hand, there is no doubt that the conduct of audits involves considerable individual judgment by accountants.[79] Different accountants may audit the same set of accounts in very different ways and with widely differing degrees of thoroughness. Moreover, the objectives and techniques for company audits, which are the types of audit with which the accounting profession is most familiar and the established principles are most concerned, may differ to some extent from those appropriate for solicitors trust accounts. In particular, company audits may be less concerned with detection of frauds or defalcations.

9.41 A further consideration is that if the requirement to conduct an audit is accompanied by more specific requirements concerning examinations of the accounts, in practice these other requirements may increase or reduce the degree of rigour of the examination. For example, if, as in Victoria, the principal requirement is to conduct "an audit made... in accordance with the [relevant statutory] rules",[80] some accountants may consider that compliance with specific requirements in the rules is sufficient, irrespective of whether they cover what accountants would usually consider necessary in an audit. On the other hand, if the specific requirements are appropriately drawn they can help to ensure that the desired degree of rigour in examinations is achieved.

C. Opinions on Matters of a General Nature

9.42 In most jurisdictions, irrespective of whether there is a requirement to conduct "an audit", there are one or more matters of a general nature on which accountants are required to express an opinion in their report. For example, they may be required to give an opinion about whether the solicitor has complied with all relevant statutory provisions relating to trust accounts. In some instances, the requisite opinion may be such that the examination needs to be similar in nature and scope to that of an audit, whether or not there is an express audit requirement. We mention below some of the general matters on which opinions are required in certain jurisdictions. Before doing so, it should be pointed out that in some jurisdictions, but not most, the opinions are to be expressed as subject to a prescribed qualification. For example, in England[81] and Tasmania[82] the expression of opinion is prefaced by the words insofar as an opinion can be based on [the] limited examination" required by the relevant statutory rules.

Compliance with Statutory Provisions

9.43 One matter of a general nature upon which an opinion is commonly required (for example, in Victoria[83] and South Australia)[84] is whether or not the solicitor has "complied with the requirements of [the equivalent of our Legal Practitioners Act] and [the] rules relating to trust accounts". There may be room for uncertainty about the extent to which such a requirement covers breaches of provisions relating to the handling, rather than the recording, of trust moneys. But in some jurisdictions, such as Queensland, there is a clear duty to report any breach of the provisions relating to handling.[85] In New South Wales, by contrast, the corresponding requirement is to express an opinion about whether the "trust records are of the nature and in the form prescribed" and "appear to have been regularly written up and properly kept".[86] In other words, the required opinion seems to concentrate on the way in which the solicitor has *recorded* trust moneys, rather than including also the way in which they have been *handled* (in particular, whether section 4l(1) of the Legal Practitioners Act has been complied with). Moreover, there is no express requirement to give an opinion about whether, as required by section 42(2) of the Legal Practitioners Act, the accounts have been kept in such a manner as to "disclose the true position in regard [to the handling of trust moneys], and to enable the accounts to be conveniently and properly audited".

9.44 In our Discussion Paper we suggested that accountants should be required to express opinions about whether the trust account records of the solicitor have been regularly and properly written up and whether the trust moneys handled by the solicitor have been properly accounted for, and also a final comprehensive opinion about whether the solicitor has complied with the statutory provisions relating to solicitors' trust accounts.[87] This suggestion was drawn largely from requirements in other jurisdictions and suggestions made to us by Coopers and Lybrand[88] and the Accounting Research Centre.[89] The Law Society is currently considering a proposal by its Chief Trust Account Inspector that accountants be required to certify whether or not "the trust account records have been regularly and properly maintained in the manner prescribed by the [Legal Practitioners] Act and Regulations" and "trust moneys handled by the solicitor have been properly accounted for and in accordance with the Legal Practitioners Act".[90]

9.45 A general indication of the effect of changes along the lines we suggested may be obtained from the survey undertaken for us by the Accounting Research Centre. It asked chartered accountants in New South Wales, first, whether they currently undertake certain types of checks when examining solicitors trust accounts and, secondly, whether they would undertake those checks under a proposed requirement to state whether

"in my opinion based on my examination of the records produced to me by the solicitor and on the explanations and information given to me in response to the inquiries which I considered it necessary to make"[91]

The solicitor has complied with the principal statutory provisions (namely sections 41 (1) and 42(2) of the Legal Practitioners Act) relating to the handling and recording of trust moneys. The survey found the following comparisons:[92]

	Percentage of respondents who "frequently" or "occasionally" undertake such checks currently	**Percentage of respondents who would "frequently" or "occasionally" undertake such checks under the proposed requirement**
Examine the solicitor's general files	27	98
Examine the solicitor's general ledger	36	79
Make a surprise visit	11	60
Obtain client confirmation of trust account balances	11	74
Check authorities for withdrawals from trust accounts	35	90
Sample trust account receipts	53	96
Check internal control system	43	91

Adequacy of Accounting Systems

9.46 In some jurisdictions, such as Victoria, accountants are required to state whether, in their opinion the solicitors "accounting systems and records... are adequate having regard to the nature of the practice".[93] A provision of this kind helps to emphasise the educative and advisory role which many accountants regard as an essential part of an auditor's abilities. The Law Society of New South Wales is currently considering a proposal by its Chief Trust Account Inspector that accountants be required to certify whether or not "the accounting systems and internal controls used by the solicitor to ensure that trust moneys handled by them have been properly accounted for were appropriate for the practice conducted by them and operated satisfactorily throughout the year".

Other Matters which should be Reported

9.47 In several jurisdictions, such as Queensland[95] and South Australia[96], there is a general residual requirement upon accountants to report any other matter relating to the trust accounts which they consider should be communicated to the authority receiving the report.

D. Frequency of Examination

9.48 In some jurisdictions, solicitors are required to provide an accountant s report once each year. In Queensland, however, a report is required every six months and, in addition to an "audit" of the records at the end of the six-month period, the accountant must carry out an "unannounced examination" at least once during the period.[97] The examination must, in effect, constitute an audit but there is no need to submit a report on it unless, broadly speaking, a breach of the law, an " irregularity', or a matter which "may adversely affect the financial position of the [solicitor] to a material extent" is discovered.[98] In New Zealand, where the examination must constitute an audit, three examinations must be conducted each year, with one annual report being submitted to cover all three examinations.[99] In Tasmania, an examination and report is required every six months.[100] In Victoria, it is only necessary to submit one report each year, but during the year the accountant must make an unannounced visit to compare the balances in the trust ledger and the bank records.[101]

9.49 Unannounced visits are not required by statute in other jurisdictions, but some accountants would regard at least one such visit each year as being desirable and even at least where the statutory requirement is for "an audit", obligatory. The Accounting Research Centre's survey suggests that in New South Wales most accountants do not make an unannounced visit to solicitors' offices.[102] Moreover, in New South Wales the accountant who is to conduct the annual examination need not be selected until after the year in question has finished. This emphasises the lack of any requirement in this State for unannounced visits or any other sort of scrutiny during the year. By contrast, in most other jurisdictions the accountant, in effect, must be chosen and notified to the relevant authority at or before the commencement of the period to be reported upon.[103] We consider this and other matters concerning the appointment of accountants in the next chapter.

9.50 It is relevant however, to reiterate here that in New South Wales every practice is to be inspected once each year by a Law Society Inspector. We know of no other jurisdiction except Victoria, where every practice is subjected to a Law Society inspection let alone to an inspection each year. Even in Victoria the inspection occurs only about every two years.[104]

9.51 An increase in the frequency of accountants examinations could be expected to increase the likelihood of effective prevention and detection of defalcations. On the other hand, of course, there would also be an increase in the accountants' fees and perhaps in the degree of disruption of solicitors practices. Many of the benefits of more frequent examinations might be obtained by supplementing the annual full-scale examination with at least one brief and unannounced visit intended mainly to have a deterrent effect and to ensure that solicitors keep their records reasonably up-to-date. Another possible approach is to require more frequent examinations of particular types of practice and/or to meet some of the cost of additional examinations from the Fidelity Fund rather than leaving it to be borne entirely by solicitors. Bearing in mind the high incidence of defalcations amongst sole practitioners,[105] there are strong arguments for subjecting them to more frequent scrutiny than other practitioners.

9.52 In our Discussion Paper we suggested that, generally speaking, the accountants examination should continue to be annual.[106] We suggested, however, that each year there should also have to be at least two unannounced visits to every sole practitioner[107] and at least one unannounced visit to every other practitioner.[108]

E. Access to Other Records and Files

9.53 A number of accountants (including our consultants Yarwood Vane,[109] and Coopers and Lybrand[110] have advised us that no audit or similarly rigorous examination can be conducted satisfactorily without having access to the solicitor s general accounts records and office files. The two principal associations of accountants have told us that in their view

> "there is no reason precluding audits of solicitors' trust accounts provided that the auditors have unrestricted access to all accounting records and related information including matter files, of the solicitors."[111]

Access to these records is often essential in order to check transfers to the general account in respect of costs, or withdrawals of trust money for purposes of investment, both of which are areas which have given rise to considerable difficulties in New South Wales in recent years. We have recommended earlier in this Report that solicitors should be required to open an office file for every matter involving the handling of trust moneys, and should be required to retain it for at least 12 years.[112]

9.54 The Accounting Research Centre's survey found that if the audit-like examination described in their questionnaires was introduced, 97 per cent of respondents to the survey would consider it necessary to examine solicitors office files, at least on occasion.[113] In relation to examinations of general accounts the corresponding proportion was 79 per cent.[114] It also found that under current arrangements, 37 per cent of accountants examined office files, and 48 per cent examined general accounts, whether frequently or occasionally.[115] In other words, a substantial number of solicitors already provide accountants with access to these records on a voluntary basis.

9.55 An important issue arises in relation to the confidentiality of material to which accountants have access. Much of the material falls within the protection of legal professional privilege. This means that, unless the client consents, the solicitor cannot be compelled to disclose the information, even in legal proceedings. But if an accountant has access to it while examining the solicitor s trust accounts, he or she might be compelled to disclose it by, for example, being subpoenaed in legal proceedings. This could cause considerable unfairness to a client who, through no action of his or her owm may lose a basic protection upon which he or she relied when disclosing the information to the solicitor.

9.56 In a number of jurisdictions (including Queensland and South Australia) accountants conducting examinations have general rights of access to office files, general accounts records and other material held by a solicitor and relating to his or her practice and trust accounts.[116] In some of these places,[117] accountants are required to report whether or not they have been denied such access. In England, a solicitor can decline to

provide such information on the ground of legal professional privilege, where applicable, but the accountant must mention any such instances in his or her report.[118]

9.57 In our Discussion Paper we suggested that accountants should have general access to office files, general accounts and other material whether of the solicitor's practice or of a related service company.[119] We suggested also that any information obtained by an accountant should continue to be protected by legal professional privilege, if applicable, save that it could be used in disciplinary proceedings against the solicitor if the relevant part of the proceedings was held in private.[120] The Law Society has expressed no opposition to these suggestions[121] and says that the suggested protection would be necessary. The Joint Committee of accountants said that general access of the kind we suggested is "essential ... for audit purposes", and added that accountants should be required to state in their reports whether they have been denied access to any such material.[122]

9.58 It is relevant to note in this context that we have recommended earlier that a Direct Payments Register should be part of the trust account records,[123] and we make recommendations later which would also give an accountant who is examining a solicitors trust accounts access to records of any nominee companies or private finance companies which the solicitor operates.[124]

F. Specific Checks

9.59 As we mentioned earlier, the report required from accountants in New South Wales states that certain checks of a relatively specific kind have been carried out.[125] For example, it refers to checks of quarterly trial balance statements produced by the solicitor.[126] In some other jurisdictions, however, there is a more extensive lost of specific checks which must be undertaken. This applies especially in Victoria, Queensland and England.

9.60 It is sufficient for the purposes of the present chapter merely to illustrate the types of specific checks which may be required. They include checking made from the trust account to the general account in respect of costs (as, for example, in England[127] and Tasmania[128]), checking that bank reconciliations have been made each month (as, for example, in Queensland),[129] and making a sample check of money paid to the general account in order to ascertain whether it should have been paid to the trust account (as, for example, in Tasmania).[130] These and other specific checks are discussed in some detail in the next chapter.

IV. RECOMMENDATIONS

9.61 In our view, the present system of accountants' examinations is manifestly and seriously inadequate. Many of its weaknesses are in its general nature, with which we are concerned in this chapter, while others relate to questions of specific technique or questions concerning the independence and training of the examining accountants, which we discuss in the next chapter.

9.62 The present requirements for accountants' examinations concentrate on relatively few and unimportant matters of form and arithmetical exactitude, rather than on thorough investigations, albeit on a sampling basis, of particular transactions (especially in known problem areas) and of the practice's financial control system. It is both remarkable and disturbing that, while New South Wales has a worse record of solicitors' defalcations than any other State, it also continues to have the least rigorous requirements concerning accountants' examinations. These examinations detected none of the 79 defalcations of which the Law Society became aware in the four years to 1984.[131]

9.63 The system of accountants' examinations has been criticised trenchantly by eminent accountants, including the New South Wales Auditor-General, as being not only vague and superficial but also potentially misleading to clients, who may erroneously believe that their money is subject to independent scrutiny akin to that of an audit. We agree with the general tenor of their views and with many of their specific criticisms. We note also that the Law Society of New South Wales appears to accept that the present examination requirements need substantial change.

9.64 The Joint Committee of the two principal associations of accountants in New South Wales has expressed the view that "there is no reason precluding audits of solicitors' trust accounts provided that the auditors have unrestricted access to all accounting records and related information including matter files, of the solicitors". It added that "so far as we are aware, the Queensland legislation [concerning audits of trust accounts] appears to have operated satisfactorily and may be a suitable model."[132]

9.65 We are convinced that accountants' examinations should be required to be much more rigorous than at present. The question then arises whether they should have to constitute an audit, as is the case, for example, in Queensland, Victoria, South Australia, the Australian Capital Territory, and New Zealand. Audits are already required for the trust accounts of some professional groups in New South Wales, including stockbrokers, real estate agents and travel agents. But the examinations could be made very rigorous and demanding without being described as an audit; this has been achieved, for example, in England, Tasmania and Ontario by listing some general requirements which the examination must meet and some specific checks which it must include.

9.66 As we noted earlier,[133] the use of the term "audit' carries with it a substantial corpus of legal principles, formal *Statements of Auditing Standards and Auditing Practices*, an extensive body of auditing literature, and many customs and connotations with which accountants are generally familiar. Not all of this corpus is relevant to the auditing of solicitors' trust accounts but much of it is, and is of great value in providing definition and guidance for both accountants and lawyers about specific requirements and techniques. It would be impracticable and unwieldy to attempt to express in statutory form more than a very small portion of this corpus. There is no doubt that, as in Jurisdictions to which we have referred earlier, an examination of considerable rigour (broadly akin to that of an audit) can be defined by compiling an extensive statutory list of requirements even though the term "audit' is not used. However, while the general rigour of an audit may be matched, the breadth of specific definition and guidance cannot.

9.67 In the light of these considerations, we conclude that the term audit should be used as the principal definition of the required type of accountants' examination. In addition however, we believe that there are advantages in specifying particular standards to be applied, purposes to be pursued, techniques to be adopted, and items to be included in reports. A number of the more specific requirements of this kind are considered in the next chapter. Here we confine ourselves to requirements concerning the general nature of the examination.

9.68 The introduction of an audit requirement would involve many solicitors paying appreciably more in accountants' fees than at present. On the other hand, if the current level of payments from the Fidelity Fund could be reduced in this State to the same level per solicitor as in. say, Victoria or Queensland, the recent substantial increases in compulsory contributions from solicitors could be reversed dramatically.[134] Moreover, the cost of audits is already being borne by solicitors in most other parts of Australia (and by members of other professions in New South Wales), yet it is solicitors in this State who have the worst record of defalcations.

9.69 Considerations of cost are, however of crucial significance to the question of frequency of audits. In the light of these considerations, and the fact that each practice is to be subject to an annual Law Society inspection, we believe that it would not be Justified, at least under present circumstances, to require more than one audit each year.

9.70 On the other hand, it is most important that accountants should play a continuing role in prevention education and detection in relation to practices which they are responsible for auditing, rather than being involved only for a very brief period after the end of the year to which the audit relates. This approach requires changes in the procedures for appointment of accountants as auditors, which we discuss in the next chapter, but is also leads us to believe that it should be mandatory for accountants to make at least one unannounced visit each year. The visit should not involve anything approaching a full audit, unless the accountant discovers serious grounds for concern Its principal aim would be to ensure that accounting records are being kept in the correct manner and are reasonably up-to-date, and to conduct simple checks for manifest errors such as debit balances or lack of agreement between trust ledger records and bank records.

9.71 For these and other reasons explained earlier in the chapter, **we recommend that solicitors' trust accounts should have to be audited each year. Without limiting the generality of that requirement, a number of other requirements of a general nature should be specified by statute.** We list these requirements in the following paragraphs.

9.72 **First, the principal purpose of the audit should be defined as the detection of frauds, defalcations, illegalities and irregularities. This would not mean, however, that accountants would have to give an opinion that no fraud etc. has taken place, nor that an accountant who acted with all reasonable care and skill would nevertheless be liable for failing to detect, for example, a well-concealed defalcation.**

9.73 **Secondly, the audit should have to be conducted in accordance with the current Statements of Auditing Standards and Auditing Practice published by the Institute of Chartered Accountants in Australia and the Australian Society of Accountants.**

9.74 **Thirdly, accountants conducting these audits should be required to state in their report whether, based on appropriate examination and sampling techniques, they are of the opinion that throughout the period covered by the report**

> **trust moneys have been handled in accordance with the relevant statutory provisions (i.e., at present, section 41 of the Legal Practitioners Act);**

the proper accounting records have been kept, and all trust moneys have been recorded and accounted for, in accordance with the relevant statutory provisions (i.e., at present, sections 41 and 42 (2) of the Legal Practitioners Act, and the Solicitors' Trust Account Regulations).

This would mean, amongst other things, that an opinion would have to be given about whether, as required by section 42(2), the records have been kept "in such a manner as to disclose the true position in regard [to the trust moneys] and to enable the account to be conveniently and properly audited".

9.75 **Fourthly, accountants conducting such audits should also be required to report**

whether, in their opinion, the practice's accounting and financial control systems are adequate for a practice of its particular nature;

any other matter which they consider should be brought to the attention of the Law Society.

9.76 **Fifthly, accountants responsible for auditing a practice should be required to make at least one unannounced visit (or, in the case of sole practitioners, at least two such visits) to inspect the practice's accounts during the period covered by the annual audit, with the principal purpose being to form an opinion whether, based on limited sampling not amounting to an audit, the accounting records are being kept in the required form and are reasonably up to date, there are no debit balances in the trust ledger, and the prescribed trial balance statements have been properly prepared. This opinion should be stated subsequently in the annual audit report, but if the accountant detects any material irregularity or breach of the law it should have to be reported forthwith to the Law Society. We make a further recommendation in chapter 10 relating to accountants' duties to report reasonable suspicions which they may form about irregularities of certain kinds.**[135]

9.77 **Sixthly, for the purposes of conducting an audit, accountants should have access not only to the trust account records but also to office files, general accounts and all other documents relating to the practice, and should be entitled to require the solicitor to provide such other information as is reasonably necessary for the purposes of the audit. If an accountant seeks access to such material or information and is refused, he or she should have to mention the refusal in the audit report. Information covered by legal professional privilege should retain that protection despite disclosure to the accountant, except where it is to be given in private session in the course of disciplinary proceedings against the solicitor.**

FOOTNOTES

1. Letter to the Commission dated 9th June 1980, p.1.

2. *Id.,* p.2.

3. University of Sydney Accounting Research Centre, “Report on Regulation 8 of the Legal Practitioners Act (1979), p.1.

4. Id., p.3.

5. *Id.,* p.1.

6. See paras.9.10-9.15 below.

7. See “Theoretical Issues and Practical Methods of Auditing Solicitors’ Trust Accounts” (a Consultants Report to the Commission, 1979), esp. at pp.18-19. The report is re-printed in our *Background Paper V* (1981).

8. *Id.,* p.20

9. Law Society’s Response, para.4.2; Joint Committee Report, para.3.

10. See para.7.5 above.

11. See Law Society’s Response, esp. paras.5.3,5.8; and see paras.9.44 and 9.46 of this Report.

12. Joint Committee Reply, paras.4.21; and letter to the Commission from Mr. W.E. Small, State Chairman, Institute of Chartered Accountants, dated 9th June 1983.

13. Letter from Mr. W.E. Small (State Chairman, Institute of Chartered Accountants) and Mr. I.C. Matheson (State President, Australian Society of Accountants) to the Law Reform Commission dated 1st August 1983. See also para.9.64 below.

14. “A Report of an Enquiry into the Certification by Accountants of Solicitors’ Trust Accounts” (1980), hereafter referred to as “Accounting Research Centre Report”. The Report is reprinted in our *Background Paper V.*

15. *Id.,* p.7.

16. *Id*., p.8.

17. *Id.,* p.9.

18. *Id.,* p.10

19. “Theoretical Issues and Practical Methods of Auditing Solicitors’ Trust Accounts’ (1979), pp.3-4.

20. International Federation of Accountants, “International Auditing Guideline No.l: Objectives and Scope of the Audit of Financial Statements” (1980), paras.7-9.

21. See Australian Society of Accountants and the Institute of Chartered Accountants in Australia, *Australian Accounting and Auditing Standards and Related Statements* (1983), pp.2001-2008.

22. *Id*., pp,3001-3166.

23. *Id*., p.2004.

24. *Ibid.*

25. *Id.,* p.2001.

26. *Ibid.*

27. *Ibid.*

28. *Id*., pp.2001-2008.

29. *Id*., pp.3001-3166.

30. See eg. *Re Kingston Cotton Mill Co*. (No.2) [1896] 2 Ch. 279; Re *London & General Bank* (No.2) [1895] 2 Ch. 673; *Re Thomas Gerrard & Sons Ltd.* [1968] CL 455; *Pacific Acceptance Corporation v. Forsyth* [1970] 92 W.N.(N.S.W.) 29; and Re Gerughty [1983] Qd R29, which related to audit of a solicitor's trust account.

31. Companies (New South Wales) Code, s.285(3)(a)(i).

32. *Id*., s.285(4).

33. Legal Profession Practice Act 1958, s.81A.

34. Special Committee to Consider the Provisions of the Legal Profession Practice Act Referring to Auditing and the administration of the Solicitors Guarantee Fund, *Final Report* (1977), p.7 (hereafter called the Dawson Committee Report).

35. See note 9.12.1 above, at pp.3127-3134.

36. *Id*., pp.3129-3130.

37. Discussion Paper, para.6.71.

38. Joint Committee Reply, para.6.

39. Mr. O'Donnell was a member of the Committee at the time, and subsequently became its chairperson.

40. Letter to the President of the Australian Society of Accountants dated 14th February 1981.

41. *Ibid.*

42. *Ibid.*

43. Standing Committee of the Law Institute of Victoria and Institute of Chartered Accountants in Australia and the Australian Society of Accountants on the accounting Provisions of the Legal Profession Practice Act and Solicitors"(Audit and Practising Certificates) Rules, Report (1976), P.1.

44. See para.9.8 above.

45. Accounting Research Centre Report, p.11.

46. See paras.9.38, 9.39, 9.48, 9.56, 9.59, 9.60, 10.25 below.

47. Accounting Research Centre Report, p.18 and Graphs.

48. *Ibid.*

49. *Id*., p.4.

50. *Ibid.*

51. Law Society's Response, paras.5.4 and 5.6.

52. *Id*., para.5.4(d).

53. Joint Committee Reply, para. 18.

54. *Ibid.*

55. See para.9.8 above.

56. Legal Practitioners Act 1898, s.42(2).

57. According to estimates obtained by the Law Society.

58. See paras.9.4-9.7 above.

59. See note 9.7 3 above.

60. See chapter 2 above.

61. See chapter II below.

62. See later in this chapter, and chapter 10.

63. See, e.g., Travel Agents Act, 1973, s.42D(2), and Travel Agents Regulations, Form 25; Auctioneers and Agents Act, 1941, s.38D; Securities Industry (New South Wales) Code, s.75, and Sydney Stock Exchange Rules, r.3(6)-(10).

64. See *Statement of Auditing Standards* (note 9.12.1. above), p.2007.

65. Law Society's Response, para.5.7.

66. See chapter 8 above.

67. See note 9.7.1 above.

68. See paras.8.14-8.15 above.

69 .Trust Accounts Act 1973, s. 16(2)(b).

70. Legal Practitioners Act 1981, s.13.

71. Legal Profession Practice Act 1958, s.81.

72. Legal Practitioners Ordinance 1970, s.58.

73. Law Practitioners Act 1982, s.91: Solicitors Audit Regulations, 1969, reg.20.

74. See note 9.31.2 above.

75. Auctioneers and Agents Act, 1941, s.38D(2).

76. See paras.9.10-9.21 above.

77. Trust Accounts Act 1973, s.16(11); Trust Account Regulations 197 3, reg.7.

78. See paras.9.12-9.1 3 above.

79. See para.9.11 above.

80. Legal Profession Practice Act 1958, s.81A(l).

81. Accountant's Report Rules, 1975, Schedule.

82. Rules of Practice 1977, Schedule.

83. Solicitors (Audit and Practising Certificates) Rules, 1965, r.16, Form 2.

84. Legal Practitioners Regulations 1982, reg.48.

85. Trust Accounts Act 1973, s.17(b).

86. Solicitors Trust Account Regulations, Form 1.

87. Discussion Paper, paras.6.75-6.76.

88. *Ibid*., and see our *Background Paper* V, p. 104.

89. See our *Background Paper* V, p.13.

90. Information supplied by the Law Society to the Commission.

91. Accounting Research Centre Report, p.11.

92. *Id.,* p.13.

93 .Solicitors (Audit and Practising (certificates) Rules 1965, Form 2, para.7.

94. Information Supplied by the Law Society to the Commission.

95. Trust Accounts Regulations 197 1, reg. 11(14).

96. Legal Practitioners Regulations 1982, reg.50(1).

97. Trust Accounts Act 197; ss.16, 18.

98. *Id*., ss.17, 18; Trust Accounts Regulations 1973, reg.8.

99. Solicitors Audit Regulations, 1969, regs.47-48.

100. Rules of Practice 1977, r.10.

101. Solicitors (Audit and Practising Certificates) Rules, 1965, Form 2.

102. Accounting Research Centre Report, p.11.

103. See paras. 10.40, 10.41 below.

104. Information provided by the Law Institute of Victoria at the request of the Commission.

105. See para.2.25 above.

106. Discussion Paper, paras.6.63, 6.76.

107. *Id*., para.7.3.

108. *Id*., para.6.76.

109. See their report to the Commission published ill Our *Background Paper* V, at p.141.

110. See their report to the Commission published in our *Background Paper* V at p 80.

111. See note 9.7.5 above.

112. See para.6.11 above.

113. Accounting Research Centre Report, pp.11-13.

114. *Ibid.*

115. *Id.,* p.10.

116. See, e.g., Legal Practitioners Act- 1981 (S.A.), s.35(l), and Legal Practitioners Regulations 1982, reg.48(2); Trust Accounts Act 1973 (Qld.), s.16(8) and (9).

117. See, e.g., Legal Practitioners Regulations 1982 (S.A.), reg.50(t)(c); Trust Accounts Act 1971 (Qld.), s.16(10).

118. Accountants Report Rules 1975, r.5.

119. Discussion Paper, paras.6.79-6.85.

120. *Id*., para.6.82.

121. Law Society's Response, para.5.15.

122. Joint Committee Reply, para.17.

123. See para.4.36 above.

124. See chapter 11 below (esp. paras.11.35, 11.60 and 11.62).

125. See para.7.18 above.

126. Solicitors Trust Account Regulations, Form 1.

127. Accountant's Report Rules, 1975, r.4(l)(d)

128. Rules of practice 1977, r.10(3)(d).

129. Trust Accounts Regulations 1971, reg. 11(11).

130. Rules of Practice 1977, r.30(3)(h).

131. See para.7.8 above.

132. See note 9.7.5 above.

133. See para.9.39 above.

134. See paras.2.19, 2.20 above.

135. See paras. 10.67-10.79.

10. Independent Scrutiny: Other Issues

I. INTRODUCTION

10.1 In the previous two chapters we made a number of recommendations relating to the general nature of two forms of independent scrutiny, namely Law Society inspections and accountants examinations. In this chapter we look at a number of other issues relating to independent scrutiny We do so under the following headings

specific aspects of examinations and inspections;

appointment, qualifications and other issues relating to accountants conducting examinations; and

duties of solicitors, bankers and accountants to report reasonable suspicions.

II. SPECIFIC ASPECTS OF EXAMINATIONS AND INSPECTIONS

A. Introduction

10.2 In this section we look first at the use of client verification as a means of checking solicitors trust account records, and then at certain other types of specific checks which could be made compulsory or at least be strongly recommended.

B. Client Verification

The Present Position

10.3 Client verification in the course of independent scrutiny involves checking with solicitors' clients whether or not the trust account records relating to their affairs disclose any inaccuracies or irregularities. It may be confined to verification of the current balance in their trust ledger account, or include verification of each transaction shown therein Under present law, Inspectors can seek client verification in the course of their inspections, and accountants can do so in the course of their examinations. The current practice is described in the following paragraphs.

10.4 **Inspectors:** Until very recently, Inspectors did not utilise the technique of client verification at least in routine inspections. Since 1983, however, experiments with client verification have been conducted by Inspectors in two areas of New South Wales, with the co-operation of the relevant regional law society.[1] The experiments were to confined to transactions in excess of $10,000 which the solicitorinvolvedhad failed to explainto the satisfactionof an Inspector conducting a routine inspection. If the Inspector considered that verification by a particular client should be sought, he or she could report accordingly to the Chief Executive Officer of the Law Society. If the Chief Executive Officer agreed that client verification should be sought, he would arrange for an appropriate letter to be sent to the client In one area, it was agreed that the letter would be sent by the Society's own accountants, and in the other area it would be sent by the accountants responsible for examining the trust account in question.

10.5 We understand that thus far verification has been sought in only three instances. The clients involved have been sent a letter[2] explaining that a "routine inspection" of their solicitors accounts has been carried out and giving details of a transaction recorded in those accounts in which the client was involved. The client is asked to indicate by ticking the appropriate box in the letter, whether or not "the transaction as described above correctly records what you intended to happen to your monies". The letter concludes: "You may also wish to write on the back of the letter your explanation of what you believe is correct". In each instance the client responded that the record was correct We have been advised by the Law Society that client verification by Inspectors may be introduced in one or two other areas, by agreement with the regional law societies in question in the reasonably near future.

10.6 **Accountants:** We have referred earlier to the Accounting Research Centre's survey of chartered accountants in New South Wales in 1979. Some 11 per cent of respondents to the to the survey that said when examining solicitors trust accounts they "frequently" or "occasionally" obtained client verification of trust account balances.[3]

Discussion

10.7 We have pointed out that client verification procedures already occur to some extent. The question arises whether they should be made compulsory, or at least be used more extensively.

10.8 It is widely accepted that the mere perusal of trust account and other records provided by a solicitor may fail to detect deliberate or negligent this handling of trust moneys, especially if the solicitor in question has sought to conceal it.[4] The likelihood of detection may increase substantially, however, if the records are checked with the clients involved in order to ascertain whether the nature and amount of the various transactions shown in the records are accurate and in accordance with instructions. Moreover, the knowledge that such verification may be sought, even of a random sample of clients, can be expected to have a significant deterrent effect on potentially aberrant solicitors. In some circumstances it may be relatively easy to prepare records (such as forged instructions) which, while effective to deceive an Inspector or accountant, are patently false to the client The importance which accountants place on client verification as a technique may be seen from the fact that, when asked by the Accounting Research Centre what checks they would make if required to conduct an audit-like examination some 74 per cent said that they would "frequently" or "occasionally" seek client verification.[5]

10.9 One of our consultants, Coopers and Lybrand, made the following comments to us about client verification.

> "In audits of commercial enterprises it is standard practice for the auditor to communicate direct with debtors to obtain confirmation of amounts owing. In common with most modern audit practices, the check is conducted on a sample basis. Usually, the requests for confirmation accompany monthly statements despatched by the client to the debtor, and the debtor is asked to reply direct to the auditor. Any discrepancies reported by debtors are expected to be thoroughly investigated by the auditor.
>
> A similar practice is used in obtaining confirmation of bank balances and loan creditors. Confirmation of creditors' balances by direct communication is not customary where creditors' statements are received by the client. Where statements are not received, however, auditors sometimes communicate direct with creditors to confirm large amounts owing.
>
> Confirmations of account balances by direct communication in controlled conditions are generally regarded as audit evidence of a high order. In some situations, no alternative audit evidence may be available.
>
> An obstacle to the adoption of direct communication checks in audits of solicitors trust accounts is that solicitors do not generally render monthly statements to clients. Frequently, statements are sent only on completion of the matter, e.g., a conveyance of property. Monthly statement despatches are not, however, a pre-requisite to direct communication checks. To overcome the difficulty, the auditor could check and mail statements specially prepared to clients selected by him for the purpose of the test. Generally, a photocopy of the ledger account avoids the necessity of producing a separate statement.
>
> It is recognised that clients are not always able to confirm whether or not the statements of accounts are correct. Nevertheless, the advantages of direct confirmation from clients are significant and it is recommended that such tests, on a sample basis, be standard practice in audits of solicitors trust accounts."[6]

10.10 Some solicitors have expressed considerable concern about client verification.[7] The most common concern is that clients who are approached for verification may believe that something must be amiss in their solicitor s practice, even though their own matters are being conducted satisfactorily. Accordingly, it is said, the solicitors reputation and practice may suffer, especially if those clients express their suspicions to other people and rumours begin to develop. Other concerns include the costs involved in an extensive verification procedure, and the danger that the procedure may be ineffective if, for example, the clients indicate satisfaction without really understanding the records sent to them. Moreover, it is said, if solicitors wished to frustrate the verification procedure they could record false addresses for the clients in question intercept the requests for verification, and then provide responses purporting to be from the client.

10.11 In Tasmania there is a specific statutory procedure for client verification in the course of accountants examinations.[8] Accountants can require solicitors to give them letters in a -bed form written on the solicitors' letterhead, seeking verification from particular clients. The number of letters required, however, must not exceed 10 per cent of the number of clients of the solicitor in question "who are involved in monies for investment or securities."[9] We understand that many accountants make use of this procedure, although they are not required to do so.

10.12 Strong support for client verification has been expressed in other jurisdictions. For example, the Dawson Committee established by the Victorian Government pointed out in 1977 that accountants auditing solicitors' trust accounts in that State have the power to seek such verification and "it is vital to the effectiveness of an audit that the power should be exercised".[10] The Committee pointed out that in the area of company audits it is common for auditors to seek verification from persons having dealings with the company.[11] We understand that client verification of solicitors' trust accounts remains uncommon in Victoria, but that some accountants seek verification on occasion and there have been some specific instances in which the Law Institute has authorised one of its Inspectors to seek verification. In New Zealand, a leading firm of accountants was asked in 1977 to report to the Law Society on matters relating to solicitors' trust accounts.[12] They described as their" single most important recommendation" the introduction of client verification on a sampling basis as part of every accountants examination.[13] They said that " the deterrent effect of this [system] should be very great".[14] They envisaged that verification would be sought by a letter in prescribed form sent by either the solicitor or the accountant, with the client being asked to respond to the accountant. We understand that accountants' examinations in New Zealand often include client verification at the initiative of the accountants in question but there is no requirement for them to do so.[15]

10.13 In our Discussion Paper we suggested that accountants should be able to seek client verification and should be required to indicate in their report whether they have done so.[16] Both the Law Society[17] and the Joint Committee of accountants[18] agreed with this view. As described earlier,[19] the Society has undertaken some experiments with client verification but these have involved specific transactions identified by their Inspectors as needing further investigation, rather than being carried out on a sampling basis as part of accountants examinations. Moreover, the Society has been unwilling to introduce client verification save where the regional law society agrees to it. To date, only two of the regional societies have so agreed.

Recommendations

10.14 In our view, client verification is a very important method of prevention and detection especially in relation to deliberate mishandling of trust money. Indeed, substantially more extensive use of this technique is one of the most sorely needed improvements in the regulation of solicitors' trust accounts. We have taken note of the degree of concern amongst solicitors that the technique may give rise to unfair suspicions and rumours. We are convinced, however, that this potential problem can be overcome by careful drafting of the prescribed form of communication with clients, extensive publicity to explain the new system and the adoption of client verification in relation to *every* solicitor. The history of routine inspections by the Law Society's Inspectors demonstrates how fears of arousing clients' suspicions can prove to be unjustified if the procedure is applied on a regular basis to all solicitors and thus becomes commonplace and generally accepted. Indeed, if

explained appropriately to the public, client verification procedures can improve the general reputation of the profession as being concerned to maintain the highest standards.

10.15 It would not be Justifiable or practicable to require client verification for every transaction shown in a solicitors trust account records, nor to require, for example, that verification must be sought from a prescribed percentage of clients. On the other hand, we believe that some degree of client verification is appropriate for every solicitor holding trust money. The basis for sampling should be left to the discretion of the person responsible for obtaining verification but should be explained in his or her report.

10.16 The question then arises whether verification should be carried out in the course of the Law Society's routine inspections, or accountants examinations, or both. In our view, both Inspectors and accountants should have the power to seek client verification We have recommended earlier, however, that each practice should be subject each year to both a routine inspection and an accountant s examination. It would not be reasonable to require that both the inspection and the examination must include verification procedures. We favour a requirement that the accountant s examination must include client verification on a sampling basis. Inspectors, on the other hand, would have discretion to undertake their own client verification if they considered it appropriate. It is relevant to note here our earlier recommendation that when inspecting a particular practice, Inspectors should have access to the reports, audit programs and working papers of the accountant responsible for examining the practice.[20]

10. 17 Accordingly, **we recommend that accountants' examinations should be required to include client verification of a sample of the solicitor's trust account records. The sampling basis should be determined by the individual accountant and explained in his or her report.** If it is considered, contrary to this recommendation that client verification should not be required in every case, we consider nevertheless that accountants should be expressly entitled to seek client verification and should be required to include in their report the nature of any client verification which they have carried out or the reasons why such verification was considered unnecessary.

10. 18 **When seeking client verification, accountants should be required to send a letter in prescribed form to the client. The letter should be accompanied by details, in a readily comprehensible form, of the trust account records which it is sought to verify and should ask the client to respond directly to the accountant. The prescribed form of letter should explain that requests for verification are required in relation to every solicitor, that clients to be contacted are chosen on a random basis, and that** a **request for verification should not be regarded as a ground for suspicion. Clients should be provided with details of all trust account entries relating to them for a recent period, rather than merely the balance currently shown in their accounts.**

10.19 In our view, the form of letter currently used by the Law Society is not appropriately drafted to allay alarm or suspicion, and could be expressed in a more readily comprehensible manner. We have no objection to adoption of the Tasmanian procedure by which the letters, although sent by the accountant and to be returned to him or her, are on the solicitors letterhead and are signed by the solicitor.[21] Where possible, client verification procedures should be coordinated with the sending of statements of account to clients in accordance with recommendations made earlier in

this Report.[22] Accountants should be entitled to communicate orally with clients if no response is received to the prescribed letter or if the response calls for clarification or investigation.

10.20 **In addition, Inspectors should be expressly empowered to seek client verification in the course of routine inspections, if they consider it appropriate to do so, provided that they use a prescribed form of letter similar to that which we have recommended above in relation to accountants.**

C. Other Specific Checks

The Present Position

10.21 We have mentioned earlier the specific checks that are currently required to be undertaken in the course of an accountant s examination in New South Wales.[23] They relate principally to identification and investigation of debit balances, and to certain arithmetical checks and reconciliations. Many accountants have prepared their own lists (sometimes called Audit Programs or Plans) of specific steps for themselves and/or their staff to take in the course of the examination. No such list, however, has been issued or endorsed by the Law Society or the associations of accountants.

10.22 The Law Society has drawn up a “check-list of steps which it requires its Inspectors to take when conducting a routine inspection. The list is lengthy, and many items involve very simple checks, especially of an arithmetical nature. There are, however, a number which merit special mention here. They are:

“Are cheques:

(a) “crossed” and marked “not negotiable - a/c payee only”

(b) “crossed” and marked “not negotiable”

(c) signed by the principal or partner”?

“Do cheque signatories satisfy themselves:

(a) that there are sufficient funds in the trust ledger account

(b) as to the authenticity of all payments”?

In relation to the Trust Journal:

"Are there any entries towards the end of the month which have been reversed in the next month. If so - check".

"Have there been any entries made from accounts in credit to other accounts for the purpose -of eliminating debit balances"?

In relation to a sample of Trust Ledger entries:

"Check [those] entries [with] documentation authorities on files in regard to:

(a) costs

(b) loans

(c) investments

(d) payments to other parties

(e) whether income from investments has been received;

(f) security or other documentation".

"List old balances and record reasons for delay in finalisation".

Discussion

10.23 The items listed in the previous paragraph relate to particular types of transactions, office procedures or entries in accounts which the Law Society's experience indicates as being causes or symptoms of mishandling. It may be argued that if such checks are regarded as a necessary part of a routine inspection they should be regarded as a necessary part of an accountants examination or at least should be included in advisory guidelines for such examinations. This is particularly so if, as we have recommended, the examinations should become substantially more rigorous, and if the thoroughness with which Inspectors can make these checks continues to be limited by the fact that, on average, they are expected to complete each inspection in one day.

10.24 We have referred earlier to the relative frequency with which problems have arisen in relation to the handling of money in respect of costs and disbursements, and we have made detailed recommendations about the rules which should be applied in this area.[24] There would be obvious advantages in requiring, or at least advising, inspectors and accountants to give special attention to the way in which costs and disbursements have been handled and recorded. The same applies to a number of other recommendations which we have made, such as requirements to prepare monthly reconciliation statements, to issue statements of account, and to record certain transactions in a Direct Payments Register.[25]

10.25 In most, if not all, other jurisdictions there is a statutory list of specific steps which must be taken in the course of an accountants' examination Such lists exist in jurisdictions (such as Queensland[26] and Victoria[27]) in which the examination is called an audit, and also in jurisdictions (such as Tasmania[28] and England[29]) in which it is called an examination. A number of the items relate to relatively minor arithmetical and book-keeping checks akin to those currently required in the New South Wales accountants' examination. Other checks required in some jurisdictions, however, relate to transfers from trust accounts to general accounts in respect of costs and disbursements,[30] debit balances[31] dormant balances (for example, those remaining unchanged for more than 12 months)[32] and other matters. Generally speaking, when accountants are required to carry out a particular type of check they also are required to state in their report that they have done so.

10.26 In South Australia the Law Society has published a "suggested audit program which is "a general guide and should be amended where required to suit the practice being audited so that sensitive areas can be given priority".[33] The program contains suggested checks, and summaries of relevant legal principles, in relation to many different aspects of the examination. Areas given special attention in the program include transactions between solicitors and clients, costs and disbursements, administration of estates and dormant balances.[34] In New Zealand, an advisory Audit Program has been prepared by the Society of Accountants and circulated by the Law Society. A report commissioned by the New Zealand Law Society recommended in 1978 that Audit Circulars should be prepared and distributed each year to accountants responsible for auditing solicitors' trust accounts.[35] In Victoria, the Dawson Committee recommended in 1977 that the Law Institute, in conjunction with the accountants associations, should distribute material "setting out what is expected of the auditor and suggesting appropriate techniques".[36] It also proposed that they should prepare

> "an audit program [which] should be issued as a guide only. It should be made plain that the work listed is a minimum and that further tests and checks may be necessary in the exercise of the auditor's discretion."[37]

10.27 In our Discussion Paper we suggested that, in addition to the checks currently required, accountants should be required to make, and report that they have made, sample checks of transfers in respect of costs and disbursements, and inquiries about transactions between the solicitor and his or her clients.[38] The Law Society responded that it did not oppose these suggestions but "would want to know what additional efficacy would be achieved."[39] We also suggested that the Law Society, in conjunction with the associations of accountants, should "settle an audit program guide and distribute it to both solicitors and accountants".[40] Both the Law Society[41] and the Joint Committee[42] of accountants responded that a uniform program could not be presented because of the variations between solicitors' practices. It is unclear to what extent they would oppose introduction of a program which is advisory only and includes alternative suggestions to meet different situations. The Joint Committee added that the program for a particular solicitor s practice should not be shown to the solicitor, thus making effective deception by the solicitor more difficult.[43] This latter comment may be more relevant to a detailed audit plan prepared by a particular accountant for a particular practice, rather than to an official audit program containing guidelines and suggestions of general application.

Recommendations

10.28 In our view, the current check-list for Law Society Inspectors in New South Wales identifies a number of important problem areas to which any thorough inspection or examination of a solicitors trust accounts should give special attention Another area meriting special attention is the handling of deceased estates, which has caused particular problems both here and in other jurisdictions. In addition we have recommended earlier the introduction of certain requirements relating, for example, to statements of account and Direct Payments Registers, which would be more likely to achieve prompt and widespread observance is at least in the first five years after their introduction they were given particular attention by accountants and Inspectors.

10.29 Accordingly, **we recommend that, in addition to certain basic book-keeping and arithmetical checks, accountants' examinations should be required to include checks of systems, and sample checks, in order to enable the accountant to express an opinion whether**

transactions in respect of

(i) the solicitor's costs and disbursements;

(ii) the administration of estates;

have been handled and recorded correctly;

the Direct Payments Register has been maintained correctly;

the requirements concerning delivery of statements of account have been satisfied;

reconciliations between the trust ledger and the bank records have been prepared each month;

conveyancing or borrowing transactions between the solicitor and his or her clients have been made in compliance with the rules and Law Society statements relating to the provision of independent legal advice for clients, and any trust moneys involved have been handled and recorded correctly.

In order to facilitate the last of these checks, solicitors should be required to disclose to their accountant all conveyancing or borrowing transactions between themselves (or an associated party)[44] **and one or more of their clients. Accountants should be required to state in their reports that they have undertaken each of these checks, and to state their opinion on each of the matters listed above.** Other matters which, in our view, should have to be stated specifically in the report are discussed elsewhere in this chapter and in other chapters.

10.30 **The Law Society, in conjunction with the two principal associations of accountants and the Auditor-General, should prepare an advisory Audit Program (or different Programs for different types of practice) and issue it to all accountants responsible for examining solicitors' trust accounts. The Program should include, amongst other things, items of the kind that are currently included in the check-list for Inspectors, especially those to which we have referred in paragraph 10.22 above. The Program should be supplemented by**

regular Audit Circulars. Accountants should be required to state in their reports that they have perused the current Program and Circulars.

10.31 **It should be made clear to accountants that the generality of their obligations to conduct an audit and to express opinions of a general nature about compliance with the law are not limited to carrying out such specific checks as are required by statute or mentioned in an Audit Program.**

10.32 **Consideration should be given to amending the check-fist for Inspectors so** as **to require Inspectors to conduct some or all of the checks which we have recommended above**[45] **should have to be conducted in the course of accountants' examinations.**

III. APPOINTMENT, QUALIFICATIONS AND OTHER ISSUES RELATING TO ACCOUNTANTS

A. Introduction

10.33 In this section we look at a number of issues relating to accountants who are responsible for examining solicitors' trust accounts. They are:

- appointment and removal;
- qualifications and training;
- carrying out other work for the solicitor;
- delivery of reports.

B. Appointment and Removal

The Present Position

10.34 At present, the accountant by whom a solicitor s trust accounts are to be examined is chosen by the solicitor in question.[46] There is no requirement that the appointment be made prior to or during the year to which the examination relates, nor that it be notified to the Law Society or anyone else prior to submission of the chosen accountant's report on his or her examination.

10.35 Solicitors are free to change accountants at will and, indeed, if their chosen accountant gives them an unfavourable report they need not forward it to the Society. Instead, they can seek a more favourable report from another accountant and send it to the Society without making any mention of the previous report The Law Society has no power to reject the solicitors choice of accountant, provided that he or she is a registered public accountant. It may, however, seek a report from a second accountant chosen either by the solicitor or, if it wishes, by the Society.[47]

Discussion

10.36 **Independence:** It is clearly of fundamental importance that accountants' examinations should be conducted by an accountant who is independent of the solicitor whose accounts are being examined. An accountant's independence is seriously compromised if he or she is not only appointed, but can be removed at will, by the solicitor being examined. There is reason to suspect that lack of independence on the part of some accountants has contributed to the failure of accountants examinations to play a significant role in reporting fraud or serious irregularities to the Law Society in New South Wales. Dishonest or incompetent solicitors may have little difficulty in finding an accountant with characteristics similar to their own, and in dispensing with the services of one whose diligence and responsibility threatens exposure.

10.37 These considerations suggest two principal options in relation to appointment and removal. The first is for both appointment and removal to be the responsibility of some authority independent of the solicitor being examined. The second is for the accountant to be appointed by the solicitor but to be appointed permanently and be removable only by, or with the approval of, an independent authority.

10.38 **Other Considerations:** Certain other considerations suggest that accountants should be appointed permanently, or at least at the beginning of the year to be covered by their examination and report. First, an accountant who has become familiar with a particular practice over a number of years maybe able to conduct examinations more efficiently, identify irregularities more readily, and pursue investigations more thoroughly. On the other hand, of course, familiarity may breed complacency, lack of independence, or a reluctance to expose mistakes which should, perhaps, have been detected earlier.

10.39 A second consideration is that, for reasons explained earlier, we have recommended that examinations should be required to include an unannounced visit during the year, an expression of general opinions about compliance with the relevant law during *the year in question* and about the adequacy of the solicitor s accounting systems, and specific checks of matters such as the preparation of reconciliation statements each month and the sending of statements of account.[48] The effectiveness of each of these recommendations depends solely or largely on the accountant being appointed at or before the beginning of the year in question.

10.40 **Procedures Elsewhere:** In each Australian jurisdiction the accountant is selected by the solicitor being examined, although in some the appointment needs approval by an independent authority (for example, the Law Society in Tasmania[49] and the Registrar of the Supreme Court in South Australia[50]). In some jurisdictions (including Queensland[51] and South Australia[52]) the

appointment must be made, and notified to a specified authority (for example, the Law Society), within a fixed period after the solicitor enters into practice or begins holding trust moneys, and the appointment remains effective until resignation or removal.

10.41 In a number of jurisdictions, a solicitor cannot terminate an accountants appointment without approval by a specified independent authority, such as the Law Society.[53] In some jurisdictions, such as South Australia,[54] approval is even necessary before resignations can take effect. The grounds on which approval may be withheld are usually rather vague. For example, in South Australia the approval of the Registrar of the Supreme Court must be obtained, and the Registrar "shall not withhold his approval if it is reasonable in the circumstances.[55] In Victoria, the law Institutes approval is required, and it must be granted if the solicitor satisfies the Institute "that it is reasonable in the circumstances to do so".[56] Some law societies have power to order the removal of a particular accountant, or to refuse to approve his or her appointment. The permissible grounds for such action may be "If the [Law Institute] is of the opinion that the auditor for any reason may not properly perform his duties" (as in Victoria),[57] or negligence or proved professional misconduct (as in England),[58] or include any "sufficient reason" (as in South Australia).[59]

10.42 **Our Discussion Paper:** In our Discussion Paper we suggested that the appointment of an accountant should have to be made and notified within a prescribed time after the solicitor in question first receives trust money.[60] We also suggested that if the solicitor intends to terminate the appointment he or she should have to provide the Law Society with reasons therefor, and that if the accountant wishes to resign he or she should have to do the same.[61] The Law Society has made no comment on these suggestions, but the joint Committee has expressed broad agreement with them, at least in relation to appointment and removal.[62]

Recommendations

10.43 In our view, the lack of procedures designed to enhance accountants' independence is a major weakness of the present system of accountants examinations in New South Wales. Moreover, in order to provide continuing, well-informed scrutiny, accountants should be appointed permanently rather than at the beginning or end of the year under examination.

10.44 Accordingly, **we recommend that**

appointment of the accountant by whom a solicitor's trust accounts are to be examined should be made by the solicitor, and notified to the Law Society, within one month of the solicitor first holding any trust money;

appointments should be subject to the Law Society's approval, and the Law Society should be entitled to withhold or withdraw approval if it believes on reasonable grounds that the accountant in question may not properly perform his or her duties or has not properly performed them in the past;

the Law Society should not withhold or withdraw approval without giving the accountant and the solicitor an opportunity to show cause why approval should be

granted, and there should be a right of appeal to the Supreme Court against a withholding or withdrawal;

solicitors should not be permitted to terminate an accountant's appointment without the approval of the Law Society, which approval should not be unreasonably withheld,

accountants should not be permitted to resign an appointment without the approval of the Law Society, which approval should not be unreasonably withheld;

persons seeking approval for termination or resignation should be required to provide reasons therefor to the Law Society.

C. Qualifications and Training

The Present Position

10.45 **At present, the required examinations of solicitors' trust accounts must be conducted by accountants who are registered as public accountants under the Public Accountants Registration Act, 1945.**[63] **In order to become so registered, an accountant must have specified professional qualifications and auditing experience (not necessarily, of course, in relation to solicitors' trust accounts).**[64] **There are approximately 6,500 registered public accountants in New South Wales. The principal associations of accountants have organised occasional seminars on examination of solicitors' trust accounts, but the seminars are not conducted on a regular basis nor are they compulsory for accountants who are responsible for examining such accounts.**

Discussion

10.46 It is sometimes suggested that registration as a public accountant should not be sufficient.[65] For example, accountants could be required to undergo special training in examination of solicitors' trust accounts before becoming qualified to conduct such examinations, and/or to attend special lectures or courses on an ongoing basis if they have been appointed to examine any solicitor s accounts.

10.47 The principal argument in favour of requiring some form of special training is that while most accountants are familiar with the task of auditing ordinary commercial accounts, relatively few have substantial experience of examining solicitors' trust accounts.[66] An accountant who is not broadly familiar with the types of transactions with which solicitors are commonly involved, and with some of the basic terminology and conventions of the legal profession, may have considerable difficulty in planning and conducting an effective examination It is less likely that common problem areas, and entries in the accounts which merit special investigation, will be, identified. There is also less likelihood that false or misleading explanations by solicitors will be recognised as such.

10.48 On the other hand, the examination of solicitors trust accounts is not a particularly large or lucrative field of work for the accounting profession. Most registered public accountants might be unwilling to undergo onerous additional training in order to become qualified to undertake this type of work. Moreover, the combination of special training requirements and a reduction in the number of accountants working in the field might cause a substantial increase in the level of fees being charged.

10.49 We know of no other jurisdiction in which special training is mandatory for accountants who examine solicitors trust accounts. However, a report by the Professional Standards Review Committee of the Institute of Chartered Accountants recommended in 1978 "the introduction for those engaged therein of compulsory lectures on specialist audits such as those of stockbrokers' and solicitors accounts".[67] In 1977 the Dawson Committee in Victoria recommended that, in addition to providing accountants with an advisory Audit Program for solicitors' trust accounts, the accountants' associations "should periodically offer short courses of instruction in the examination of solicitors' trust accounts".[68]

10.50 In New Zealand, a firm of accountants commissioned by the Law Society to review the existing systems for examination of solicitors' trust accounts in that country reported that

> "the audit of a solicitor's trust account is an onerous and difficult task, particularly with the smaller legal firms. Accordingly it is usually necessary for the auditor to understand the procedures and legal requirements involved in running a practice."[69]

The report recommended that consideration be given to the introduction of a special practising certificate for accountants examining solicitors' trust accounts, but added that

> "when first introduced, the standard of competence required to obtain the certificate could not be raised significantly without affecting the adequate supply of people willing and able to undertake these audits."[70]

10.51 In our Discussion Paper we suggested that, as at present, all registered public accountants should be qualified to conduct accountants' examinations.[71] The Law Society appears to agree with this suggestion.[72] The Joint Committee of accountants[73] agreed, although it expressed concern that if the responsibilities involved in examining solicitors' trust accounts became too onerous, especially in relation to the expression of opinions involving questions of law, it might be necessary for examinations to be conducted by persons "who have the skills of a solicitor as well as an accountant".[74]

Recommendation

10.52 We accept that the examination of solicitors trust accounts is a difficult task and requires some areas of knowledge which accountants are unlikely to acquire in carrying out other work such as company audits. On the other hand, many accountants have to become familiar with specialist types of work and specialist jargon, even within, for example, the general field of company audits. Moreover, if onerous special training became a pre-requisite for appointment to examine solicitors trust accounts, there might be serious adverse effects on the availability and cost of those who are qualified for such appointment, especially in country areas.

10.53 We have recommended earlier that certain specific checks in the course of examining solicitors' trust accounts should be required by statute, and that others should be included in advisory Audit Programs and Circulars sent to all accountants carrying out such examinations.[75] We have also recommended that the Law Society's Inspectors should be entitled to examine audit programs and working papers used by particular accountants for their examination.[76] In our view, these measures, together with a modest requirement for attendance at special seminars on solicitors trust accounts, would meet much of the need for special training and guidance. Unless these measures prove to be insufficient, we do not believe that it would be desirable to introduce any form of special certificate as a pre-requisite for appointment to examine solicitors trust accounts.

10.54 Accordingly, **we recommend that**

accountants' examinations should have to be conducted by accountants registered under the Public Accountants Registration Act, 1945;

the Law Society, in conjunction with the principal associations of accountants, should organise at least once each year a seminar relating to examination of solicitors' trust accounts;

accountants who are responsible for examining such accounts should be required to attend at least one of these seminars every two years.

D. Other Work for the Solicitor

The Present Situation

10.55 Accountants who have been appointed to examine a solicitor's trust accounts may also carry out other work for the solicitor. Indeed, they may be an employee of the solicitor. Whether as an employee or otherwise, they may be wholly or partially responsible for preparing the accounts which they are then required to examine and report upon.

Discussion

10.56 An accountants examination obviously cannot be relied upon as a form of independent scrutiny of the accountants examining accounts which he or she prepared. Problems of independence can also arise if the accountant, although not responsible for preparing the accounts, is closely involved in the solicitor's affairs as a result, for example, of preparing his or her tax returns.

10.57 The Dawson Committee in Victoria recommended in 1977 that the examining accountant should not be permitted to carry out any other work for the solicitor except auditing of other accounts (such as the general account) and "such advisory or consulting duties as are consequential upon" these tasks, unless the Law Institute approves otherwise.[77] This proposed limitation subsequently became law in Victoria.[78]

10.58 In our Discussion Paper we suggested a restriction similar to the Victorian one to which we have referred.[79] The Law Society has disagreed with this suggestion,[80] but it has been endorsed by the joint Committee of accountants who said that the examining accountant should not be a client of the solicitor or act in any other capacity as an accountant for example in the preparation of the solicitor s tax returns".[81] The Auditor-General has commented as follows

> "The proposal that the auditor should not have other connections with the solicitor is... strongly supported. The independence of the auditor is vital to the successful discharge of the proposed duties. It is reasonable for the Law Society to see that there maybe economic advantage in having the audit work performed by an accountant who has been involved in the preparation of the accounts. That involvement itself is the key to the danger. One who has helped construct an accounting base or the information brought from it inevitably loses the independence critically to review and comment on it."[82]

Recommendation

10.59 **We recommend that, save with the approval of the Law Society, accountants who have been appointed to examine a solicitor's trust accounts should not be permitted to carry out any other work for that solicitor except**

> **the auditing of other accounts maintained by the solicitor in the course of his or her practice;**
>
> **advisory or consulting duties consequential on his or her function as the examining accountant or as auditor of other accounts of the practice.**

They also should be prohibited from acting as the examining accountant for any solicitor of whom they have been an employee at any time within the two years prior to the period covered by the examination. Examining accountants should be required to state in their reports that they have not contravened these prohibitions.

10.60 This recommendation would not prevent accountants from conducting examinations even though, at the request of and in close collaboration with the solicitor being examined, they carry out a considerable amount of work for clients of the solicitor. Although such a link may seriously compromise the independence of the accountant, we do not consider that it would be reasonable or practicable to make it the subject of a general prohibition. On the other hand, a very close link of this kind might constitute, in combination perhaps with other factors, grounds for the Society to exercise the power to withhold or withdraw approval which we have recommended earlier.[83]

E. Delivery of Reports

The Present Position

10.61 Under the present system in New South Wales, the prescribed form of report by an examining accountant is headed "To: The Law Society of New South Wales" but, in practice, the report goes to the solicitor who, if he or she wishes, then submits it to the Law Society.[84] If the solicitor does not submit it, he or she will have to obtain and submit another report in the prescribed form (whether or not from the same accountant) in order to obtain a renewal of her annual practising certificate.[85]

Discussion

10.62 The present system enables solicitors not only to suppress an unfavourable report entirely but also, if they decide to pass on such a report to the Society, to conceal irregularities by altering, destroying or manufacturing certain trust account records or other evidence. In some jurisdictions, such as Victoria,[86] the accountant must report to a specified independent authority (usually the Law Society) and provide the solicitor with a copy. Of course, in those Jurisdictions where the solicitor cannot remove the examining accountant without approval, there is not the same risk as in New South Wales that an unfavourable report may be suppressed entirely and a replacement then obtained from another accountant

10.63 In our Discussion Paper we suggested that the accountant should have to report to the Law Society and send a copy to the solicitor.[87] The Law Society agreed that the report should be made to it but added that

> "there is an argument against a copy being given to the solicitor, namely that if irregularities are disclosed the solicitor will be given an opportunity of tampering with those records which might be required as evidence for the purpose of disciplinary proceedings."[88]

The Joint Committee of accountants supported our suggestion and, in response to the concern expressed by the Law Society, pointed out that the accountants working papers and report would contain evidence of the state of the records, particularly if they were the subject of a qualification in the report".[89]

Recommendation

10.64 We believe that the present arrangements for delivery of reports are thoroughly inadequate and that in order to ensure that reports are neither suppressed nor tampered with they should be sent directly to the Society rather than via the solicitor. This procedure would also help to impress upon accountants their public responsibility to provide independent scrutiny in accordance with statutory requirements rather than to provide a personal service for the solicitor.

10.65 In our view, there is merit in the Law Society's concern about immediate delivery to the solicitor of a copy of the report. Whilst we accept that some evidence may nevertheless be available from other sources, the solicitor may be able to alter or manufacture sufficient evidence to cast doubt upon or provide a credible explanation for, any irregularities reported by the accountant.

10.66 **We recommend that accountants should be required to submit their report directly to the Law Society, and that the Society should then be responsible for forwarding a copy of the report to the solicitor unless it considers that the report should be withheld in the interests of preventing, detecting or preserving evidence of irregularities. The accountant should not be entitled to disclose his or her report to the solicitor without the approval of the Law Society.**

IV. DUTIES TO DISCLOSE REASONABLE SUSPICIONS

The Present Position

10.67 Solicitors are required by statute to report to the Prothonotary of the Supreme Court and "facts or circumstances which give rise in [their] mind to a reasonable suspicion that the trust funds of some other solicitor (not being [their] client) are not in order".[90] The report must be made in the form of an affidavits upon receiving such an affidavit[91] the Prothonotary may bring it forthwith before the Supreme Court for consideration of disciplinary action, or may refer it to the Law Society "for such inquiry and action if any, as it thinks fit."[92]

10.68 We have been informed by the Prothonotary that in a typical year he receives one or two such affidavits. Usually, we understand, the affidavits are reliable and lead to the imposition of disciplinary or other sanctions. None of the 79 defalcations discovered by the Law Society during the last four years came to its notice as a result of solicitors' affidavits to the Prothonotary, although

one was brought to the attention of the Prothonotary, and thence the Law Society, by a solicitor who did not submit an affidavit.[93] A further four were disclosed by solicitors, other than the defaulting solicitor, directly to the Law Society rather than via the Prothonotary.[94]

10.69 There is no comparable duty on bankers, accountants or other persons who may have access to solicitors' trust account records, except in so far as arises from the form of report specified by accountants' examinations.

Discussion

10.70 When a serious defalcation occurs, it is by no means uncommon to hear a number of solicitors say that they had known or suspected for some time that the particular solicitor was dishonest or incompetent. No doubt some of these comments arise from the wisdom of hindsight but there are, nevertheless, strong grounds for believing that many solicitors fail to comply with the duty of disclosure which we have described above. It is perhaps inevitable that some solicitors will be unduly reluctant to disclose reasonably-held suspicions, but the formalities involved in the currently prescribed procedure may aggravate this reluctance.

10.71 Accountants who are responsible for examining solicitors' trust accounts are, of course, in a good position to detect irregularities. At present, their duties of disclosure are very limited and apply only to disclosure in an annual report (which the solicitor may be able to suppress) rather than in an immediate report made directly to the Law Society. Banks are also in a good position to detect irregularities and to do so more promptly than accountants, whose contact with the solicitors' practice is far from continuous. Considerable criticism has been directed recently at banks which allegedly failed to take appropriate action in response to extraordinary transactions involving a Queensland solicitor s trust account.[95] It was eventually discovered that the solicitor had been responsible for defalcations exceeding $2 million. We understand that in New South Wales no defalcations have been discovered in recent years as a result of information initially reported by an accountant or bank.

10.72 In Queensland, solicitors are under a duty of disclosure similar to the current duty in New South Wales, save that the report is to be made to the Law Society and need not be in the form of an affidavit.[96] In Ontario, the Law Society has ruled that, generally speaking, solicitors are under a duty to bring to the attention of the Law Society "any instance involving or appearing to involve professional misconduct or conduct unbecoming ... or reflecting on the honour of the [profession]" where there is a "shortage of trust funds".[97]

10.73 In several jurisdictions, accountants responsible for examining solicitors' trust accounts are under certain duties to make prompt disclosure to the Law Society without waiting to do so in their annual report. For example, in the Australian Capital Territory they must, as soon as practicable, report in writing" to the solicitor and "immediately afterwards" to the Law Society, if they have

reason to believe -

(a) that there is any loss or deficiency of trust moneys;

(b) that there has been any failure to pay or account for trust moneys; or

(c) that there has been a failure to comply with any provision of [the Legal Practitioners Act relating to trust moneys]."[98]

10.74 In Queensland, branch managers of banks holding trust accounts "designated or evidenced as such" are under a statutory duty to inform the Department of Justice and the Law Society

"forthwith whenever the trust account is overdrawn or whenever a cheque drawn on the trust account is dishonoured by reason of insufficiency of funds in the trust account."[99]

In South Australia, banks are required to report to the Attorney- General and the Law Society any deficiency in a solicitor s trust accounts.[100] In Western Australia, however, banks are " not obliged to inquire into the application of moneys deposited to" solicitors' trust accounts and are in no way liable in respect of any misapplication of those moneys".[101]

10.75 In our Discussion Paper we suggested that the statutory duty which currently applies to solicitors should be amended so that the report must be in writing but not necessarily in the form of an affidavit, and must be made to the Law Society.[102] We suggested that the duty, as amended, should apply also to examining accountants and to bankers.[103] The Law Society has indicated that it agrees with these suggestions.[104]

Recommendations

10.76 In our view, a duty on solicitors, bankers and accountants to make prompt disclosure of reasonable suspicions that a solicitors trust account is not in order could play a significant role in preventing and detecting defalcations and other serious mishandling of trust moneys. The need for such a duty is emphasised by the unacceptably and uniquely high incidence of defalcations in this State. On the other hand, it is important that the duty should not be so extensive as to be unduly onerous, nor so vague as to be of little utility.

10.77 **We recommend that solicitors and accountants conducting examinations of solicitors' trust accounts, should be under a general statutory duty to report promptly to the Law Society any facts or circumstances which have given rise in their minds to reasonable suspicions that**

a solicitor has faded properly to pay or account for trust moneys, or is highly likely to do so in the immediate future;

a solicitor has committed a material breach of the statutory provisions relating to the handling and recording of trust moneys;

a solicitor's trust account is overdrawn or has debit trust ledger balances for which no satisfactory explanation has been provided; or

cheques drawn on a solicitor's trust account have been dishonoured due to an insufficiency of funds in the account.

We recognise that this duty is in some respects vague and general, though not as much so as the current duty on solicitors. Nevertheless, we believe that it is sufficiently defined to have practical effect and not to be unduly onerous on those who are subject to it.

10.78 **We also recommend that banks should be under a general statutory duty to report promptly to the Law Society**

whenever a solicitor's trust account is overdrawn; or

whenever a cheque drawn on such an account is dishonoured.

In order to assist bankers to comply with this duty, **we recommend that all trust bank accounts held by a solicitor should have to include the words " Solicitors Trust Account" in their title.**

10.79 In order to encourage compliance with the duties described in the above two paragraphs and also to provide due protection for the solicitor being reported upon **we recommend that any report made by solicitors, accountants or bankers should remain confidential to the Law Society save to the extent that it is necessary to disclose it in the course of disciplinary or court proceedings or in order to comply with duties of disclosure to** t**he police.** This would not, of course, prevent the Society from instituting its own inspections or investigations into the matters raised in the report, but the Society should not be entitled to make any other decision adverse to the solicitor (such as cancellation of a practising certificate) on the bas's of the report rather than on evidence gathered by other means and disclosed to the solicitor.

FOOTNOTES

1. See N. Mainwaring, "Client Verification", *Law Society Journal* (N.S.W.), (July 1984), vol.22, p.355.

2. For the form of letter, see *Ibid.*

3. Accounting Research Centre Report, p.13.

4. See, e.g., Barr, Burgess and Stewart, “Review of Trust Account Audits” (1978), paras.4.05-4.07 (a report for the New Zealand Law Society)

5. See note 10.6.1 above.

6. See their report in our *Background Paper* - V, pp.81-82.

7. See, e.g., *Law Society Journal* (N.S.W.), (Sept 1984) vol.22, pp.501-503. See also the reply by the Society’s Chief Executive Officer, at p.619.

8. Rules of Practice 1977, r.31.

9. *Id*., r.31(2).

10. Dawson Committee Report, p.11.

11. *Ibid.*

12. See Barr, Burgess and Stewart, “Review of Trust Account Audits” (1978).

13. *Id*., para.4.87.

14. *Id*., para.4.14.

15. See, in relation to client verification and solicitors’ nominee companies, New Zealand Law Society, “Solicitors Nominee Companies and Contributory Mortgages’, p.7.

16. Discussion Paper, para-6.89.

17. Law Society’s Response, para.5.20.

18. Joint Committee Reply, para.5.

19. See paras 10.4-10.5 above.

20. See para.8.24 above.

21. See para.10.11 above.

22. See paras.6.31-6.32 above.

23. See para.7.18 above.

24. See chapter 5 above.

25. See paras.4.36, 6.31-6.32 and 6.34 above.

26. See esp. Trust Accounts Regulations 1973, reg.11.

27. See esp. Solicitors (Audit and Practising Certificates) Rules 1965, r.16, Form 2.

28. Rules of Practice 1977, esp. r.30.

29. Accountants Report Rules, 1975, esp. r.4.

30. See, e.g., Rules of Practice 1977 (Tas.), r.30(3)(d); Accountants Report Rules, 1975 (Eng.), r.41(l)(d).

31. See, eg.Trust Accounts Regulations 1973 (Qld.), reg. 11(9); Solicitors (Audit and Practising Certificates) Rules 1965 (Vic.), Form 2, cl.6.

32. See eg. Trust Accounts Regulations 1973 (Qld.), reg. 11(15); Solicitors (Audit and Practising Certificates) Rules 1965 (Vic.), reg.32B,

33. Law Society of South Australia, *Legal Practitioners Trust Accounts Manual,* p.41.

34. *Id*., pp.44, 46, 47, 51, 58-61.

35. Barr, Burgess and Stewart, “Review of Trust Account Audits” (1978), para.4.48.

36. Dawson Committee Report, p.9.

37. *Id.,* p.10.

38. Discussion Paper, para.6.76.

39. Law Society’s Response, para.5.12.

40. Discussion Paper, para.6.78.

41. Law Society’s Response, para.5.14.

42. Joint Committee Reply, para.16.

43. *Ibid.*

44. For a suitable definition of this phrase, see Law Society of N.S.W., “Special Bulletin to All Members: Borrowing Transactions” (No.2 of 1979), p.4.

45. See para.10.29 above.

46. See Solicitors Trust Account Regulations, reg.8.

47. *Id*., reg.8(5).

48. See paras.6.31-6.32, 6.34 and 9.74-9.76 above.

49. Rules of Practice 1977, r.29.

50. Legal Practitioners Regulations 1982, reg.35.

51. Trust Accounts Act 1973, s.14.

52. Legal Practitioners Regulations 1982, regs.35, 40.

53. See, eg. Legal Practitioners Regulations 1982 (S.A.), reg.41, Solicitors (Audit and Practising Certificates) Rules 1965 (Vic.), r.11.

54. Legal Practitioners Regulations 1982, reg.41.

55. *Ibid.*

56. Solicitors (Audit and Practising Certificates) Rules 1965, r.11.

57. *Id*., r.5(2).

58. Accountant's Report Rules, 1975, r.3(2).

59. Legal Practitioners Regulations 1982, reg.35(2)(c).

60. Discussion Paper, para.6.66.

61. *Ibid.*

62. Joint Committee Reply, para.12.

63. Solicitors Trust Account Regulations, reg.8.

64. See Public Accountants Registration Act, 1945, s.18; and Public Accountants Registration Board, "Registration as a Registered Public Accountant: Guidelines on Accounting and Auditing Experience".

65. See, eg. para.10.49 below.

66. For discussion of the special difficulties which may be involved in examining solicitors trust accounts, see, e.g., the Dawson Committee Report, pp.5, 9; Joint Committee Reply, paras.11, 12.

67. "Report of the Professional Standards Review Committee" (1978), Summary, p.16.

68. Dawson Committee Report, p.9.

69. Barr, Burgess and Stewart, "Review of Trust Account Audits" (1978), para.4.45.

70. *Id*., para.4.46.

71. Discussion Paper, para.6.67.

72. Its submissions to the Commission are not entirely clear or consistent on this point: see "Statutory Interest Account and Solicitors' Trust Accounts' (1979), pp.14-15, and Law Society's Response, paras.5.9 and 5.10.

73. Joint Committee Reply, paras.11, 12.

74. *Id.,* para. 11.

75. See paras.10.29-10.32 above.

76. See para.8.24 above.

77. Dawson Committee Report, pp.6-7.

78. Solicitors (Audit and Practising Certificates) Rules 1965, r.5(3).

79. Discussion Paper, para.6.70.

80. Law Society's Response, para.5.11.

81. Joint Committee Reply, para.13.

82. Letter to the Commission dated 16th November 1983.

83. See para.10.44 above.

84. Solicitors Trust Account Regulations, reg.8 and Form 2.

85. *Id*., reg.8.

86. Solicitors (Audit and Practising Certificates) Rules 1965, reg.17.

87. Discussion Paper, para.6.77.

88. Law Society's Response, para.5.12.

89. Joint Committee Reply, para. 15.

90. Solicitors' Practices Rules, r.14.

91. *Ibid.*

92. *Ibid.*

93. Information supplied by the Law Society at the request of the Commission.

94. Para.7.8 above.

95. See eg. *The Weekend Australian,* 10th-11th November 1984, p,16,

96. Queensland Law Society Rules, rule 77.

97. Law Society of Upper Canada, *Professional Conduct Handbook,* ruling 33.

98. Legal Practitioners Ordinance 1970, s.62. See also, for example, Solicitors (Audit and Practising Certificates) Rules 1965 (Vic.), r.16(2A), Trust Accounts Act 1973 (Qld.), s.17 which includes a duty to report any matters which "may adversely affect the financial position of the I solicitor] to a material extent .

99. Trust Accounts Act 1973, s.27.

100. Legal Practitioners Act, 1981, s.36.

101. Legal Practitioners Act, 1893, s.35(1).

102. Discussion Paper, para.6.41.

103. *Ibid.*

104. Law Society's Response, para.4.4.

11. Investment of Clients' Money

I. INTRODUCTION

11.1 Solicitors in New South Wales are commonly asked by clients to play some role in investing their money. Often the intended investment is a loan secured by a mortgage. In some instances, the money is received and invested by the solicitor through his or her trust account. In many other instances, however, it is received and invested by a nominee company, or a private finance company, in which the solicitor has an interest (often the controlling interest).

11.2 We have mentioned earlier in this Report the substantial number of irregularities and defalcations which have arisen from solicitors involvement in investing money for their clients.[1] In a number of these instances the investments have included loans to the solicitors themselves or to companies which they control. These defalcations have caused considerable loss and hardship for members of the public, who may be only partially compensated, if at all, by the Solicitors' Fidelity Fund and, moreover, usually have to wait some months or even years before receiving any compensation from the Fund. This huge drain on the Fund's resources has caused an increase in recent years of more than $1 million in the annual level of compulsory contributions from solicitors to the Fund.[2] Millions of dollars each year have been transferred to the Fund from the Statutory Interest Account instead of being allocated to legal aid and legal education.[3] The Law Society and other authorities have had to devote very considerable amounts of time and money to investigating irregularities and defalcations, pursuing disciplinary and criminal proceedings, and attempting to prevent similar conduct in future.[4] The reputation of the profession has also suffered significant harm. Between 1980 and 1984, more than $2 million was paid (or has been reserved for possible payment) under the professional indemnity insurance scheme as a result of claims relating to solicitors conduct of mortgage or lending transactions. In most cases the money being lent was passed through the solicitor s trust account.[5]

11.3 We begin this chapter by looking at three topics which are relevant to investment transactions whether they are made through the solicitor s trust account or through his or her nominee or private finance company. The topics are

- borrowing from clients;
- instructions for investments;
- registers and summaries of investments.

We then look at whether solicitors should be permitted to operate nominee companies or private finance companies and, if so, whether they should be subject to the same rules as apply to solicitors' own trust accounts and/or to other rules.

II. BORROWING FROM CLIENTS

A. The Present Position

11.4 In 1975 the Court of Appeal in New South Wales made the following comments in *Harvey's Case* about solicitors borrowing money from their clients:

> "Where there is any conflict between the interest of the client and that of the solicitor, the duty of the solicitor is to act in perfect good faith and to make full disclosure of his interest. It must be a conscientious disclosure of all material circumstances, and everything known to him relating to the proposed transaction which might influence the conduct of the client.....
>
> A solicitor, who deals with his client while remaining his solicitor, undertakes a heavy burden. Where a solicitor discovers that continuing to act for his client will, or may, bring the interests of his client and his own interests into conflict, it will be a rare case where he should not, at least, advise his client to take independent legal advice ...
>
> A conflict of interest which is avoidable, and ought to be avoided, is that which arises from a deliberate proposal of the solicitor that his client deal with him ... Even the tender of advice to his client to have independent legal advice, although of importance, does not really overcome the objection to the solicitor having proposed, invited or encouraged the client to deal with him or his company ...
>
> In the absence of very special circumstances, a solicitor who promotes himself as the dealer with his client misuses his position.... Therefore he ought neither to promote, suggest nor encourage a client to deal with him, but rather should take all reasonable steps positively to avoid dealing directly, or indirectly, with his client."[6]

11.5 In 1975 the Law Society sent a circular to all solicitors summarising the views expressed by the Court in *Harvey's Case,* including those to which we have referred above.[7] In 1979 the Society published a ruling which, in effect, prohibited solicitors from borrowing money from their clients unless

> the client is represented by an independent solicitor for the transaction; or
>
> the solicitor makes full disclosure of his or her interests in the matter, and the client receives advice from an independent solicitor who then signs a prescribed Certificate of Independent Advice.[8]

The prohibition covers loans made to an “associated party”, which is defined as including

> “any member of the immediate family of [the] solicitor or of his partner or of his employee and any corporation partnership, syndicate, joint venture or trust in which [the] solicitor or any member of his immediate family or of that of his partner or employee has or have any beneficial interest whether vested or contingent”.[9]

> “Immediate family” is defined as including the solicitor s spouse, child, grandchild, sibling, parent or grandparent.[10] The prohibition does not apply, however, where the client making the loan is a member of the solicitor’s immediate family or is a company falling within one of the categories specified in the ruling (for example, a bank, a registered life insurance company, or “listed company”.[11] There is also provision for the Law Society to approve loans in particular cases, whether prospectively or retrospectively.[12]

B. Discussion

11.6 The Law Society ruling to which we have referred was prefaced by a statement that the Society’s Council

> “has been concerned for some time at the increasing number of trust account discrepancies attributable directly or indirectly to solicitors borrowing funds from clients or investor members of the general public where the purpose of such borrowing is that the funds raised may be used by the solicitor or members of his family for some on-lending or other personal investment by him or them.”[13]

The Society recognised that the ruling “is essentially, not innovative; rather it seeks to apply existing principles clearly and concisely to present-day transactions”.[14] But, as the Society pointed out, “solicitors generally speaking, have experienced difficulty, in the current economic climate, in applying to commercial loan transactions in which they seek or are likely to become personally involved” the principles which had been enunciated by the Court of Appeal in *Harvey’s Case* and in earlier rulings by the Society.[15]

11.7 Since the Law Society’s ruling was made in 1979, there appears to have been a significant reduction in the incidence of borrowings from clients, and of defalcations or irregularities arising out of such borrowings as do occur. It seems, in particular, that there has been a substantial reduction in the number of solicitors who make a regular habit of borrowing from clients. We return to regular borrowings later in this chapter, when discussing private finance companies.[16]

11.8 On the other hand, there continue to be some instances of defalcations or irregularities arising from borrowing from clients.[17] Moreover, there is a reasonable likelihood that a substantial up-turn in the real estate market might increase the incidence of borrowings made contrary to the Law Society's ruling, and a subsequent sharp down-turn might cause serious defalcations. The effect of the economic climate on solicitors' observance of ethical rules was acknowledged by the Law Society in the statement to which we referred above. It should be noted also that the requirement that a Certificate of Independent Advice be obtained is not necessarily an effective safeguard if the borrowing solicitor is unscrupulous, the certifying solicitor is careless or irresolute, or the client is naive.

11.9 In several other jurisdictions, specific rules about borrowing from clients have been imposed in recent years. In Queensland, for example, there is a general statutory prohibition on such borrowings unless the client has independent advice or falls within specified exceptions similar to those in the ruling of the Law Society of New South Wales.[18] In Victoria, there is a broadly similar prohibition unless the solicitor

> "is able to discharge the onus of proving that full written disclosure was made to the client and that the client s interests were fully protected in the circumstances of the case whether by independent legal representation or otherwise."[19]

The prohibition covers loans to the solicitor s immediate family but that family is defined as including not only those relatives included in the New South Wales definition but also spouses (which includes de facto spouses) of those relatives.

C. Recommendation

11.10 It may become necessary at some future time to impose an absolute prohibition on solicitors acting for clients in relation to borrowing transactions between them, irrespective of whether the client obtains a certificate of Independent Advice. We do not, however, propose such a prohibition at this stage. First, the Law Society's ruling is reasonably strict and has had beneficial effects, not all of which may have been manifested as yet in the incidence of irregularities or defalcations. Secondly, the risk of problems arising over borrowing transactions would be reduced by the adoption of recommendations which we have made in earlier chapters (for example, in relation to independent scrutiny of trust accounts) and later in this chapter (especially in relation to private finance companies).

11.11 However, **we recommend that the substance of the Law Society ruling in 1979 about borrowing from clients should be embodied in statutory regulations. Also, the definition of the solicitor's immediate family should be extended to include spouses of the relatives currently listed, and spouses should be defined as including de facto spouses.**

III. INSTRUCTIONS FOR INVESTMENTS

A. The Present Position

11.12 At present, there is no requirement in New South Wales to the effect that, before investing trust moneys, solicitors must obtain their clients' instructions in writing.

B. Discussion

11.13 We have referred earlier[20] to the disputes and difficulties which can arise, and have arisen over the nature of investments made by solicitors on their clients' behalf. For example, clients have asserted that they directed that the investment be secured in a certain way, or be made at not less than a specified rate of interest, and that the direction has not been followed. Even where no dispute arises, the task of an examining accountant or Inspector may be made more difficult, time-consuming and expensive by the lack of adequate documentation to explain investment transactions and to establish their propriety.

11.14 In several jurisdictions there are specific requirements in relation to written authorisation for investments. In Queensland, for example, all withdrawals from the trust account "for the purpose of the investment howsoever", or "the loan ... to any person", of the money withdrawn must be authorised by the client in writing in advance.[21] There is an exception where the withdrawal is "for the purposes of paying for any land chattels of livestock for the purchase in the name of the client of which the moneys in question were paid into the trust account".[22]

11.15 In Victoria, solicitors are required to obtain the "prior written authority of their clients before lending any money under a mortgage, or any other document purporting to secure or regulate the repayment of moneys, if "the principal or interest ... is to be collected by" the solicitor.[23] The authority must be in one of two prescribed forms. One form is a general authority for use where a "continuing instruction is to be given to ... advance monies on freehold first mortgage investments without the lender previously specifying any particular first mortgage security".[24] The form provides, amongst other things, for the client to specify a maximum percentage of the property value which may be loaned under any such first mortgage. The other form is a specific authority which includes details of the amount and terms of the loan, the manner and amount of valuation of the security, a prominent indication if the security is secondary to other securities, and other matters.[25]

11.16 In our Discussion Paper, one of us suggested that withdrawals of trust money for the purposes of investment should have to be authorised in writing in advance.[26] The Auditor-General for New South Wales specifically endorsed this suggestion.[27] The Law Society of New South Wales subsequently proposed a new statutory regulation broadly similar to the Victorian one to which we have referred above, and with similar prescribed forms.[28] The only significant difference is that the requirement to obtain written authorisation would extend also to any loans to a person who "is related to the solicitor, directly or indirectly", whether or not secured or regulated by a mortgage or other document.[29]

C. Recommendation

11.17 We recommend **that solicitors should be subject to a general requirement to obtain the client's written authorisation in a prescribed form before using trust money for the purposes of investment.** The general and specific forms currently prescribed in Victoria have the support of the Law Society in this State and are appropriate for prescription here. It may be appropriate to prescribe one or more other forms to suit certain other types of investment transactions. It may also be appropriate to make certain limited exceptions to the general requirement which we have recommended; as is the case, for example, in Queensland.[30] We do not however, consider it necessary in this Report to make specific recommendations on these issues.

IV. REGISTERS AND SUMMARIES OF INVESTMENTS

A. The Present Position

11.18 We have described earlier in this Report the current obligations upon solicitors in New South Wales to make and retain records relating to trust money.[31] There is no requirement to maintain anything in the nature of a separate register of trust money received or disbursed for the purpose of investment, nor is there any specific requirement to provide clients with summaries of such transactions. It is, however, a common practice for solicitors to provide an "epitome of mortgage" to the parties to a mortgage transaction. The epitome usually includes details of the lender and borrower, the amount of money lent, the date on which it was lent, the date on which it is repayable, the rate of interest and the dates on which instalments of interest are due, and particulars of the security sufficient to enable it to be identified.

B. Discussion

11.19 We have mentioned earlier the difficulties and disputes which can arise over the nature of investments arranged by solicitors for their clients.[32] The maintenance by each solicitor of a register containing basic details of investment transactions, and the provision of similar details to the parties involved, would be of considerable assistance in reducing errors, uncertainties and arguments. The register would be of particular value to an examining accountant or Inspector. The Accounting Research Centre's survey of New South Wales accountants in 1979 found that 79 per cent of respondents considered that solicitors should be required to maintain a "trust account investment register".[33]

11.20 Solicitors in most Australian States are now required to keep registers of securities and/or investments.[34] In Queensland, for example, solicitors must record in a Mortgage Register prescribed details relating to each "loan or security document" in relation to which they are authorised to collect principal or interest.[35] In Victoria, however, the corresponding requirements

are more extensive. Broadly speaking, prescribed details of securities in relation to which solicitors are authorised to collect principal or interest must be recorded in a Mortgage Register,[36] prescribed details of negotiable securities for money and other securities and documents of title held on trust must be recorded in a Register of Securities,[37] and prescribed details of "every investment of trust monies for or on behalf of any person" must be entered in a Register of Investments unless it falls within the ambit of the Register of Securities.[38] Entries in the Register of Securities must be made "forthwith"[39] and those in the Mortgage Register "within one month"[40] after the occurrences to which they relate. We understand that consideration is being given to amalgamating the Securities and Investments Registers. In relation to each mortgage which is entered in the Mortgage Register, Victorian solicitors are also required to provide lenders with a Summary of Mortgage containing the same details as are recorded in the Register.[41] The principal provisions in Victoria and Queensland are reproduced in Appendices IV and V respectively of this Report.

11.21 In our Discussion Paper we suggested that solicitors should be required to maintain a register of mortgage securities and mortgage investments, but not of other types of securities or investments.[42] The register would be required to contain details of the kind which at present are usually included in epitomes of mortgages. The Law Society subsequently proposed a statutory regulation requiring maintenance of a Securities Register which, broadly speaking, would be required to include prescribed details of all securities, documents regulating repayment of money, or deposits of trust money, in relation to which the solicitor in question is authorised to collect principal and/or interest. This proposal is broader than the current requirement in Queensland but may not cover all investment transactions of the kind which in Victoria, must be recorded in a Register of Investments. We reproduce the proposal in Appendix III of this Report.[43]

C. Recommendations

11.22 We welcome the general thrust of the Law Society's proposals for a Securities Register, but we consider that there should also be a requirement to register unsecured investments, as is currently the case in Victoria[44] and South Australia.[45] The Society's proposal would, in fact, cover many unsecured investments because of the extended meaning which it gives to the word "securities". The definition includes not only mortgages, bills of sale and so on but any " loan contract (whether evidenced in writing or not)", "any document purporting to... regulate the repayment of moneys", and any "deposit of money" held on trust " by or under the control of the solicitor".[46] In our view, this definition unduly stretches the normal concept of securities and accordingly risks causing considerable confusion and unwitting non-compliance on the part of solicitors.

11.23 **We recommend that solicitors should be required to maintain a Securities and Investments Register containing prescribed details of**

all mortgages and other securities which are held in their name on trust or under which they are authorised to collect principal and/or interest;

all investments of trust monies for or on behalf of any person and for which there is no such mortgage or security.

11.24 We have expressed this recommendation in general terms, but there may be a case for certain limited exceptions. For example, the Law Society has proposed an exception for securities handed to a solicitor in a sealed packet for safe custody only.[47] in relation to the details which ought to be prescribed, we agree with the substance of the proposals made by the Law Society.[48]

11.25 **Entries in this Register should have to be made within a prescribed time. The Register should form part of the trust account records and therefore, amongst other things, be subject to the same independent scrutiny as other parts of those records.**

11.26 **We recommend also that solicitors should be required to provide lenders within a prescribed time with a Summary containing the same details of transactions made on their behalf as are included in the Register.**

V. NOMINEE COMPANIES

A. The Present Position

11.27 Many solicitors in New South Wales operate nominee companies. A common purpose of these companies is to act as trustee of those clients of a solicitor who wish to lend money on mortgage. The companies usually have no assets of their own (except a nominal amount of paid-up capital) and earn no income of their own. They are merely means for making investments on behalf of solicitors' clients.

11.28 Nominee companies are of particular value where a solicitor has a client who wants to borrow, say, $30,000 on the security of a mortgage and also has, say, five other clients (not necessarily known to each other) who between them have $30,000 which they wish to lend on such security. if the five clients combine as mortgagees in a "contributory mortgage", considerable legal and administrative difficulties may arise. These can be largely avoided, however, if the five clients pay their respective contributions to the solicitors nominee company which then becomes the lender on trust for them. The records of the company show that the particular mortgage is held on behalf of the clients and the company executes a declaration of trust in their favour. The company is managed and controlled by the solicitor and, subject to the terms of the declaration of trust, he or she, through the company, takes whatever action needs to be taken in relation to the mortgage. Another advantage which can be derived from the use of a nominee company is the provision of anonymity for lenders who do not wish their identity to be known to those borrowing from them.

11.29 Money received by solicitors' nominee companies is not thereby money received by solicitors themselves. Accordingly, it is not subject to the statutory provisions relating to the handling and recording of trust moneys by solicitors, independent scrutiny of solicitors trust

accounts, and reimbursement of defalcations through the Solicitors' Fidelity Fund. The nominee company must, however, comply with the general law of trusts.

B. Discussion

11.30 We have mentioned certain benefits which can be obtained by solicitors and their clients through the use of nominee companies. Generally speaking, these benefits seem unobjectionable from the viewpoint of the public interest. However, it seems clear that most, if not all people who lend money through solicitors' nominee companies do so because of their relationship with and confidence in, the solicitor as a solicitor. It is often only the professional status of the solicitor which gives the investor the confidence to invest his or her money through the solicitor. Also, it is often only that status which gives the investor confidence to allow the solicitor to choose the form of the investment. The investor usually pays little regard to whether the mortgage is taken in the name of the solicitor or the name of the solicitor s nominee company. Yet, under present law, the choice can have crucial effects on the degree of protection afforded to the investor. Clients are often aware in a general sense of the system of regulation applying to solicitors' trust accounts, and the availability of compensation in the event of defalcations. They are much less likely to be aware that these protections do not apply to money invested through solicitors' nominee companies. Indeed, they may not be aware that they are unlikely to have a right to claim against the solicitor personally in relation to any mishandling of such money.

11. 31 Moreover, solicitors' nominee companies are not generally subject to the same degree of regulation as other financial intermediaries such as banks, building societies or finance companies. They are usually exempt proprietary companies, and thus not subject to the audit provisions of the Companies Code.[50] Also, it seems to be accepted, at least in New South Wales, that they are not subject to those provisions in the Companies Code[51] and the Securities Industry Code[52] which govern financial intermediaries dealing with the public.

11.32 Solicitors' nominee companies are lawful throughout Australia, but in some States, notably Victoria and Tasmania, they are subject to specific statutory requirements. In Victoria, each of the members and directors of the company Must be a solicitor or other person approved by the Law Institute.[53] The company must not undertake any activity other than holding property as "a nominee or trustee for another person."[54] Amounts paid by lenders or borrowers to the company are required to be passed through the solicitor s own trust account and the provisions relating to the Mortgage Register must be complied with in relation to mortgages in the name of the company.[55]

11.33 In Tasmania each member and director must be a practitioner but sole practitioners are prohibited from being a member or director.[56] Each company must be formed with the approval of the Law Society.[57] The company's books of account are deemed to be part of the practitioner s books of account, and its "books of account and affairs" are subject to the rules governing legal practitioners in the same way as if money held by the company is part of the practitioner s trust account.[58] The acts of the company are deemed to be those of each of its directors for the purposes of rules about professional conduct, and breach of the rules relating to the companies is deemed to be unprofessional conduct in the course of practice as a legal practitioner.[59] The directors are also required to guarantee jointly and severally the repayment of money deposited with the company, and the payment of interest to be earned on it.[60]

11.34 In our Discussion Paper we suggested adoption of rules along the lines of those in Victoria and Tasmania to which we have referred above, save the Tasmanian rule against sole practitioners being members or directors of a nominee company.[61] The Law Society subsequently proposed a draft regulation relating to nominee companies (see Appendix III).[62] The proposed regulation restricts shareholding and directorship of such companies to solicitors, subject to special provisions relating to sole practitioners' companies. Nominee companies would be restricted to the activity of holding and/or dealing with property as trustee for other persons. Certain details of transactions would have to be recorded in the companys records and provided in writing to the borrower "as soon as practicable after payment of"[63] the loan. Payments to and from nominee companies would have to be made through the solicitors trust account. In its original form, the Society's draft regulation would have prohibited both the nominee companies and the solicitors involved from receiving any director indirect financial benefits "save for the professional costs of the solicitor of acting as the solicitor in the relevant transaction".[64] Subsequently the Society proposed that this prohibition should apply only to the companies themselves, and that solicitors should be advised that they may "make a charge for the administration costs of the mortgage provided that the client has approved and is fully aware of the nature and amount of this charge."[65]

C. Recommendations

11.35 We agree with the general tenor of the Law Society's proposed regulation, subject to certain additional rules derived from the Victorian and Tasmanian provisions. **Accordingly, we recommend that solicitors should be entitled to operate nominee companies subject to the following conditions.**

All shareholders and directors of the company should have to be solicitors (subject to an exception in the case of sole practitioners, along the lines currently proposed by the Law Society).[66]

The company's activities should have to be confined to holding or dealing with property on trust.

The company and its directors should be prohibited from deriving any financial benefit from its activities, other than solicitors' professional costs for acting as a solicitor.

The directors should be required to guarantee jointly and severally the repayment of principal, and the payment of due interest, to lenders.

The company should be required to execute appropriate declarations of trust, or otherwise to evidence the trust, in respect of each transaction.

Money received by the company should be subject to the statutory provisions relating to solicitors' trust money in the same way as if it is received by the solicitor as trust money (including, for example, the provisions relating to the keeping of Registers and the provision of Summaries to lenders).

The company's accounts should be deemed part of the solicitors' trust accounts, and be subject to the statutory provisions relating to such accounts (including, for example, the provisions relating to inspections and accountants' examinations).

For the purposes of the rules of professional conduct, the acts of the company should be deemed to be also the acts of each of its directors, and the acts of solicitors as directors should be deemed to be acts in the course of their practice as solicitors.

As appears from these recommendations, we do not favour the Law Society's recent proposal that solicitors should be entitled to charge "administration costs" on mortgage transactions handled by their nominee companies.[67] At least in its present form, the proposal leaves too much scope for solicitors' nominee companies to become involved in entrepreneurial mortgage-broking replete with conflicts of interest and other dangers of the kind which as we point out later in this chapter, have arisen in relation to solicitors' private finance companies.[68] The need to prevent nominee companies from developing in this manner would increase if, as we recommend later, solicitors are prohibited from operating private finance companies.[69]

11.36 It is beyond the scope of this Report to make recommendations about the Solicitors' Fidelity Fund. However, a logical corollary of the above recommendations is that money received by a nominee company should be taken into account in determining the statutory deposit which a solicitor must make of a prescribed portion of his or her trust funds[70] and that lenders should have the protection of the Fidelity Fund in the same way as if the money was received by the solicitor rather than by the company.

VI. PRIVATE FINANCE COMPANIES

A. The Present Position

11.37 Broadly speaking, solicitors' private finance companies may be described as companies which are operated or controlled by solicitors or "associated parties"(such as close relatives, employees, or companies in which solicitors have an interest) and conduct the business of borrowing and lending money.[71] The usual practice is for the companies to make loans, secured by mortgages, out of a pool of money deposited with the company by various people, most of whom are clients of the legal practice run by the solicitor or solicitors involved in the company.

11.38 Since money received by a solicitors private finance company is not money received by the solicitor, it is not subject to the statutory provisions relating to solicitors' trust moneys and trust accounts. Moreover, the company's relationship to the lender is that of debtor rather than of trustee. There are no statutory provisions in New South Wales relating specifically to solicitors' private finance companies and there is considerable doubt whether they are subject to the provisions in the Companies Code or the Securities Industry Code relating to financial intermediaries dealing with the public.[72]

11.39 A number of relevant comments were made, however, by the Court of Appeal in 1975 in Harvey's Case,[73] which involved a solicitors private finance company. Some of the court's comments about solicitors borrowing from clients have been referred to earlier in this chapter.[74]

The following extracts from the Court's judgment are of special relevance to solicitors involvement in private finance companies.

> "A conflict of interest which is avoidable, and ought to be avoided, is that which arises from a deliberate proposal of the solicitor that his client deal with him ... It can make no difference if he is not a party directly but the transaction is with a company in which he bas an interest. Even the tender of advice to his client to have independent legal advice, although of importance, does not really overcome [this] objection ....
>
> In the absence of very special circumstances, a solicitor who promotes himself as the dealer with his client misuses his position. A solicitor who constantly promotes dealings with various clients clearly misuses his position and puts it beyond his capacity to observe his primary duty to his clients ....
>
> [I]f a solicitor does occasionally act in the role of a loan- broker, he will need to take special care to ensure that the relationship of confidence engendered by the solicitor/client relationship does not cloud the client s judgment The client must not be encouraged to assume that the solicitor has necessarily any special expertise in the commercial, as distinct from the legal concomitants, of the transaction under consideration ....
>
> ... [A] solicitor who does act as a loan- broker ought to regard himself as precluded, by the very relationship between him and his client, from commending to his client a loan to a company, or for a venture, in which the solicitor has an interest. A solicitor ought not to intermingle his personal affairs, in a sense including the affairs of companies, ventures or others with whose financial position he has a personal connection with the affairs of his client."[75]

11.40 A few years later, in 1979, the Law Society of New South Wales issued two rulings of special relevance to private finance companies.[76] The first, relating to solicitors borrowing from their clients, has been outlined earlier in this chapter.[77] It relates to private finance companies because it covers borrowing from a solicitor s clients by an "associated party", which is defined to include any company "in which [the] solicitor or any member of his immediate family or that of his partner or employee has or have any beneficial interest whether vested or contingent".[78] As mentioned earlier,[79] the ruling requires that the lender either is given full disclosure of the solicitor s interests and receives advice from an independent solicitor or is represented by an independent solicitor in relation to the loan.

11.41 A few months after this ruling was issued, the Law Society published a ruling relating specifically to borrowings by solicitors' private finance companies.[80] This second ruling, in effect, added certain restrictions to those specified in the first one. Broadly speaking, it prohibited loans from the company to the solicitor or an associated party unless all persons who have money on loan to the company have obtained advice from an independent solicitor about the company's proposed loan to the solicitor.[81] It also prohibited solicitors from making an express or implied representation that money lent to the company is "repayable at call or on a specified date if there is a possibility of a substantial delay in repaying ... on the due date,"[82] and from representing that

loans to the company are secured “unless there is a direct matching of those funds with a particular (and readily identified) security”.[83] Perhaps the most important aspect of the ruling however, is a requirement that the company must not pay “a lesser rate of interest to depositors than that which is received from borrowers.”[84]

11.42 There are no accurate statistics about the prevalence of solicitors private finance companies in New South Wales in recent years, nor about the amounts of money which they have handled. There is no doubt, however, that during the latter part of the 1970s they were common and, in total, handled hundreds (and perhaps thousands) of millions of dollars. It is also clear that some of these companies were run without adequate regard for the interests of the solicitors clients involved.[87]

11.43 Many of the irregularities and defalcations detected in recent years took place, or had their origins, prior to the Law Society’s rulings in 1979. Inquiries made of solicitors by the Law Society suggest that since those rulings were made there has been a substantial decline in the number of these companies.[88]

B. Discussion

11.44 Solicitors’ private finance companies, like solicitors’ nominee companies, can serve useful purposes. In particular, they may enable borrowers to obtain finance more readily than might otherwise be the case, facilitate the pooling of small amounts from a number of would be lenders, and provide lenders with desired anonymity. On the other hand, under present arrangements they have a number of substantial disadvantages from the viewpoint of lenders, or borrowers, or both.

11.45 First, they have the disadvantages to which we referred earlier in relation to nominee companies.[89] For example, although it seems clear that many lenders and borrowers deal with companies because they believe they are run by solicitors, they need not be run solely or principally by solicitors, money paid to the company is not subject to statutory provisions governing solicitors trust moneys and trust accounts and, generally speaking, the solicitors involved are under no personal liability in relation to such money. Money received by the company may not be subject to the protection of the Solicitors’ Fidelity Fund.[90] Moreover, it is by no means clear whether the companies are subject to the provisions of the Companies Code and Securities Industries Code.[91]

11.46 Secondly, private finance companies can have a number of other disadvantages which do not apply to nominee companies. For example, since the money lent to the company is not held by it on trust, the lender has less protection than with a loan to a nominee company. Also, private finance companies have, in practice, been more likely than nominee companies to be involved in making loans to the solicitor or an associated party, to become involved in financial and commercial activities of a kind and scale which the solicitor is not competent to manage, and to give rise to defalcations.

11.47 A major potential danger of private finance companies is that, by contrast with nominee companies, they may be run as profit-making enterprises, which heightens the potential for conflict

between the interests of solicitors and those of clients dealing with the solicitors' companies. This danger, however, is reduced substantially if, as the Law Society has ruled,[92] the companies are not allowed to pay lenders lesser rates of interest than they receive from borrowers. Indeed, this ruling removed much of the attraction for solicitors of handling investment transactions through private finance companies rather than through nominee companies, and together with the requirements relating to independent legal advice for clients lending to solicitors or associated parties,[93] may be the principal reasons for the apparently substantial decline in the number of private finance companies.

11.48 There seems no reason to doubt that such a decline has occurred, but it is by no means certain that the present number of private finance companies is as low as was reported recently to the Law Society. It is possible that some companies controlled by solicitors or associated parties were not reported, and that there are companies with which solicitors have a nexus which is very close but not of the kind about which the Law Society inquired. In any event, the recent decline may be reversed-if economic conditions change or the passage of time makes some solicitors less conscious of the disciplinary action and professional opprobrium which have been incurred in recent years by a number of solicitors who became involved in such companies. The advent of advertising, and increased competition both within the profession and with other professions or institutions, may heighten some solicitors interest in operating private finance companies.

11.49 **Regulation in Other States:** Solicitors' private finance companies are the subject of specific statutory regulation in only two States, namely Tasmania and Victoria. We outlined earlier in this chapter the Tasmanian provisions relating to nominee companies.[94] These provisions, which were adopted in 1970, apply also to private finance companies.

11.50 In Victoria, a substantial number of private finance companies have existed for many years, especially in large country centres, and some have become very large operations. In 1976, a committee of the Law Institute recommended that solicitors should not be permitted to operate or control private finance companies.[95] It said that such arrangements "are fraught with peril for both client and Solicitor.[96] A Joint standing committee of the institute and the two principal associations of accountants said that" solicitors should not conduct investment companies due to the conflict of interests which may arise".[97] It added that if such companies were allowed to continue they should be subject to regulation by statute.[98]

11.51 The Attorney General of Victoria then established the Dawson Committee to inquire into these and other issues. The Committee said that solicitors private finance companies suffered from the following defects:

"(i) potential conflicts of interest;

(ii) inherent weaknesses in financial structure;

(iii) absence of public accountability and disclosure;

(iv) an altered legal relationship between solicitor and client;

(v) absence of personal liability;

(vi) unequal status of creditors concerned; and

(vii) public misapprehension as to the nature of the investment."[99]

11.52 The Committee concluded, however, that

> "the fact that solicitors have been able to develop substantial mortgage banking businesses does indicate they are fulfilling a need in so doing. Any attempt now to prohibit solicitors from engaging in mortgage banking would involve the winding up of what have become substantial and, in most of the cases examined by the committee, well-run enterprises. It is for these reasons that the committee favours control rather than prohibition ....
>
> Solicitor-controlled investment companies run the same risks as other financial intermediaries ... However, it is doubtful whether members of the public appreciate the risks involved, believing instead that the professional status of the solicitor affords sufficient protection. It is for this reason that the committee believes that, as far as possible, the protections which exist in respect of funds which a solicitor is required to deposit in a trust account should be extended to deposits with an investment company controlled by him."[100]

11.53 The Committee recommended that solicitors private finance companies should be required to obtain a licence from the Commissioner for Corporate Affairs, to have their accounts audited each year, and to comply with a number of other requirements relating, for example, to maintenance of a prescribed ratio of paid- up capital and reserves to deposits, maintenance of an investment register, restriction of securities to real estate mortgages, proper valuations of real estate, and restriction of loans to no more than a prescribed percentage of the value of the real estate in question.[101]

11.54 Considerable debate ensued after the Committee's report was published. The Law Institute, for example, urged the Government to prohibit private finance companies and added that, if they were to be regulated rather than prohibited, the Institute should be the regulatory authority. Eventually, after discussions involving the Commonwealth Government and all State Governments, a system of licensing by the Victorian Commissioner for Corporate Affairs was established. Details of the licensing scheme, including the rules with which licensed companies must comply, are contained in Appendix IV of this Report. In essence, the scheme includes rules of the kinds recommended by the Dawson Committee, and certain other rules requiring, for example, that the company's accounts be audited by the same auditor who audits the solicitor s trust accounts,[102] that lenders be told that they "may have no recourse to the Guarantee Fund" (the Victorian equivalent of or Fidelity Fund),[103] that loans to the solicitor or an associated party be made only with prior written approval of the Commissioner,[104] and that the solicitor personally guarantees due payment of the company's liabilities.[105] The licensing scheme came into operation in February 1984. By late in that year some seven companies had applied for licences but no applications had yet been determined.

11.55 **Our Discussion Paper:** In our Discussion Paper we said that private finance companies have "a dangerous potential for fraud, mismanagement and professional irresponsibility".[107] But

we suggested that "if they can be regulated in a way which so far as impracticable, ensures adequate protection for members of the public" they should be so regulated rather than being prohibited.[108] We suggested that regulation should be effected by the Law Society and be broadly along the same lines as in Tasmania, but that consideration should also be given to rules of the kind proposed by the Dawson Committee. We suggested also that this system of regulation should not exempt companies from complying with such other requirements, for example, under the Companies Code or Securities Industry Code, as may apply to them.[109]

11.56 The Law Society responded that it "does not disagree" with our suggestion that the Tasmanian system should be adopted, in which event the Society's draft regulation in relation to nominee companies "may well have to be amended to include corresponding references to private finance companies".[110] The Society said that it needed more time to consider our suggestions,[111] but it has not subsequently proposed any system for regulation of private finance companies.

C. Recommendations

11.57 The operations of some solicitors private finance companies have caused very serious problems, both in New South Wales and elsewhere.[112] A heavy cost, both financial and otherwise, has been paid by both the public and the profession as a result of the irregularities and defalcations which have occurred.

11. 58 Rulings made in 1979 by the Law Society of New South Wales[113] appear to have reduced substantially the number of private finance companies and the incidence of problems arising from their activities. However, this decrease may be reversed, especially if economic conditions change or solicitors become subject to greater competitive pressures. Moreover, the current scarcity of private finance companies means that prohibition of them would cause less disruption than in previous years. By contrast, it seems reasonably clear that a major and perhaps determining factor in the decision to control rather than prohibit private finance companies in Victoria has been the continuing prevalence of such companies in that State.[114]

11.59 There is a substantial body of opinion amongst solicitors, including some leaders of the profession that private finance companies should be prohibited. The Court of Appeal in Harvey's Case clearly considered their operation to be generally contrary to the proper role of a solicitor.[115] Most if not all of the benefits which such companies can provide to members of the public can also be provided by nominee companies,[116] and the latter type of companies provide greater protection for the public. Moreover, most of the benefits which private finance companies can provide for solicitors in New South Wales are also obtainable from the use of nominee companies. This applies, for example, to the role of the two types of company in attracting legal work and thus professional fees. Other possible financial benefits of private finance companies are already substantially curtailed by the Law Society's prohibition on such companies paying lenders lower interest rates than are charged to borrowers.[117]

11.60 **For these reasons, we recommend that solicitors' private finance companies should be prohibited. Solicitors currently having an interest in such companies should be given a reasonable time (say, two years) within which to withdraw from them or wind them up. If,**

however, it is considered that such companies should not be prohibited, they should be required to be licensed by the Corporate Affairs Commission in accordance with a scheme of the kind currently administered by the Commissioner for Corporate Affairs in Victoria.[118]

11.61 We prefer the Victorian rather than the Tasmanian[119] system for regulating private finance companies, principally because it is more detailed and stringent, more compatible with methods of regulating other financial intermediaries, and more capable of being adopted in a substantially uniform manner across Australia. Without limiting the generality of our agreement with the Victorian scheme, we regard the following specific aspects of it as being especially important:

a requirement that the accounts be audited by the person who audits the solicitors trust accounts;[120]

rules relating to assets/liabilities ratios, and liquidity;[121]

rules about the types of security permissible, the methods of valuation of securities, and the ratio between the amount of the loan and the value of the security;[122]

requirements concerning the maintenance of registers of transactions; and the provision of regular summaries to lenders;[123]

a rule that clients must be notified that they may have no recourse to the Fidelity Fund;[124]

a prohibition on loans to the solicitor or an associated party unless made with the written approval in advance of the licensing authority.[125]

11.62 Although we believe that a licensing system, if established, should be under the control of the Corporate Affairs Commission, we consider that the Victorian approach gives insufficient recognition to the need for close integration with the Law Institute's regulatory responsibilities in relation to other aspects of solicitors' activities. Lack of an integrated and comprehensive understanding of a solicitors affairs may lead to deliberate or careless mishandling of moneys going undetected by the regulatory authorities. Accordingly, **we recommend that if solicitors' private finance companies are regulated rather than prohibited, the Law Society should be entitled to examine the accounts and other records of such companies.** We consider that this recommendation provides sufficient scope for co-ordinated and comprehensive supervision of solicitors' affairs, and that giving the Corporate Affairs Commission correspondingly broad rights of access is unlikely to be necessary and would raise major difficulties about the confidentiality of solicitor- client communications.

FOOTNOTES

1. See paras.2.23, 2.26 above.

2. See para.2.13 above.

3. *Ibid*.

4. See para.2.18 above.

5. Information supplied by Law Cover at the request of the Commission.

6. *Law Society of N.S.W v. Harvey* [1976] 2 N.S.W.L.R. 154, at 170-172.

7. Law Society of New South Wales, “Memorandum to All Members” (No.23 of 1975), 17th June 1975.

8. Law Society of New South Wales, “Special Bulletin to all Members: Borrowing Transactions” (No.2 of 1979), pp.3-5.

9. *Id*., p.4.

10. *Ibid*.

11. *Id*., p.3.

12. *Id.*, p.4.

13. *Id*., p.1.

14. *Ibid*.

15. *Ibid*.

16 .See paras.11.37-11.62 below.

17. See, e.g., the Solicitors’ Statutory Committee decisions in Price (No.12 of 1982) and Howell (No.6 of 1982).

18. Queensland Law Society Rules, rr.68D, E. See also the decision of the Court of Appeal in England in *Wills v. Wood* (Law Society Gazette, 28th March 1984, p.867, and 2nd May 1984, p.1211).

19. Solicitors (Professional Conduct and Practice) Rules 1948, r.8

20. See paras.4.53-4.54 above.

21. Trust Accounts Act 1973, s.8(2).

22. *Ibid*.

23. Mortgage Register and Nominee Company Rules 1977, rr.2.4.7.

24. *Id*., Schedule 1, Part B.

25. *Id*., Schedule 1, Part A.

26. Discussion Paper, para.4.57.

27. Letter of Auditor General to the N.S.W. Law Reform Commission, dated 16th November 1983, p.2.

28. Draft Solicitors Trust Account Regulations, reg. 14 (see Appendix III of this Report).

29. *Ibid*.

30. See para.11.14 above.

31. See, in particular chapters 4,5 and 6.

32. See paras.4.53-4.54 above.

33. Accounting Research Centre Report, p.5.

34. See Legal Practitioners Regulations, 1982 (S.A.), regs.26-34; Rules of Practice 1977 (Tas), r.23; and notes 11.20 2, 3, and 4 below.

35. Queensland Law Society Rules, r.68G.

36. Mortgage Register and Nominee Company Rules 1977, r.4.

37. Solicitors (Audit and Practising Certificates) Rules 1965, r.28.

38. *Id*., r.30.

39. *Id*., r.29

40. Mortgage Register and Nominee Company Rules 1977, r.4

41. *Id*., r.10.

42. Discussion Paper, para.7.44

43. Draft Solicitors Trust Account Regulations, regs.2, 15 (see Appendix III of this Report).

44. See para.11.20 above.

45. See note 11.20.1 above.

46. *Id*., reg.2.

47. *Id*., reg.15(2)(m).

48. *Id*., reg.15(2)(a)-(k).

49. Solicitors (Audit and Practising Certificates) Rules 1965, r.30A(2), reprinted in Appendix IV of this Report.

50. Companies (New South Wales) Code, s.279.

51. See, esp., ss.5 and 164-177.

52. See, esp., ss4, 43, 48, 51, 56, 67: Securities Industry Regulations, reg.26.

53. Mortgage Register and Nominee Company Rules 1977, rr.2, 3.

54. *Id*., r.3.

55 .*Id*., rr.4, 9.

56. Rules of Practice 1977, rr.35, 36.

57. *Id*., r.36

58. *Id*., r.38(l)(c), (2)

59. *Id*., r.37.

60. *Id*., r.38(d)(ii).

61. Discussion Paper, paras.7.14, 7.16, 7.18.

62. Draft Solicitors Trust Account Regulations, reg.13.

63. *Id*., reg.13(8).

64. *Id*., reg.13(6).

65. The Society has proposed that advice in these terms should be included in a bulletin issued by it to all solicitors (Letter from the President of the Society to the Attorney General, 11th July 1984).

66. See Appendix III, reg.13(2).

67. See para.11.34 above.

68. See, e.g., paras.11.39-11.47, 11.50-11.52, and 11.55-11.60 below.

69. See para.11.60 below.

70. Legal Practitioners Act, 1898, s.42A.

71. See, e.g., the definition in Law Society of New South Wales, “Special Bulletin to All Members: Private Finance Companies” (No.3 of 1979), p.1.

72. See notes 11.31.2 and 11.31.3 above; see e.g., Australian Central Credit Union v. Consumer Affairs Commission, 28 September 1984, Supreme Court of South Australia, Olsson J.

73. *Law Society of N.S.W. v. Harvey* [1976] 2 N.S.W.L.R. 154.

74. See para. 11.4 above.

75. See note 11.39.1 above, at pp.171-172.

76. The Society had promulgated a ruling in 196i relevant to private finance companies (see R. Atkins, N.S.W Solicitor’s Manual (3rd ed., Law Book Co., Sydney, 1975), pp.245-246). The ruling placed substantial restrictions on solicitors involvement in such companies but clearly was not complied with by some solicitors in existing years.

77. See paras. 11.5-11.6 above.

78. Law Society of New South Wales, “ Special Bulletin to All Members: Borrowing Transactions” (No.2 of 1979), p.4.

79. See para.11.5 above.

80. Law Society of New South Wales, “Special Bulletin to All Members: Private Finance Companies” (No.3 of 1979).

81. *Id*., cl.2(i) and (ii).

82. *Id*., cl.2(c).

83. *Id*., cl.2(d).

84. *Id*., cl. 3.

85. See disciplinary proceedings against solicitors arising out of their conduct of private finance companies, such as Bolster v. Law Society of New South Wales, 20 August 1982, Supreme Court o f New South Wiles, Court of Appeal; and the Solicitors' Statutory Committee decisions in Sanders, Dickson, Gianacas and Kafer, (1981) 19 Law Society Journal 129; Nash, (1981) 19 Law Society Journal Supplement 20; and Crisp, (No.4 of 1982), 16 February 1984.

86. Information supplied by the Law Society at the request of the Commission.

87. See note 11.42.2 above.

88. See note 11.42.2 above.

89. See paras.11.29-11.31 above.

90. See Legal Practitioners Act, 1898, s.56.

91. See para.11.38 above.

92. See para. 11.41 above.

93. See para. 11.5 above.

94. See para. 11.33 above.

95 .Report of Conveyancing Committee, see Conflict of Interest and Investment of clients' Monies' Law Institute Journal, (1976), vol.50, p.277.

96. *Id*., p.280.

97. Standing Committee of the Law Institute of Victoria and the Institute of Chartered Accountants in Australia and the Australian Society of Accountants on the Accounting Provisions of the Legal Profession Practice Act and Solicitors (Audit and Practising Certificates Rules, Report (1976),

98. *Ibid*.

99. Dawson Committee Report, p.36. The Committee discussed these defects in detail at pp.36-43.

100. *Id*., pp.50, 51.

101. *Id*., pp.52-55.

102. See Appendix VI, Schedule B, cl.2(g).

103. *Id*., Schedule 1, Part 2, cl.5.

104. *Id*., Schedule B, cl.2(m).

105. *Id*., Schedule B, cl.2(q).

106. Information supplied by the Victorian Commissioner for Corporate Affairs at the request of the Commission.

107. Discussion Paper, para.7.31.

108. *Ibid.*

109. *Id*., paras.7.35-7.38.

110. Law Society's Response, paras.6.5, 6.6.

111. *Id*., para.6.5.

112. See paras. 11.42, 11.46, 11.50 above.

113. See paras.11.40, 11.41 above.

114. See, e.g., the quotation from the Dawson Committee report in para. 11.52 above.

115. See para. 11.39 above.

116. See paras. 11.28, 11.30, 11.44 above.

117. See para. 11.41 above.

118. See paras. 11.53-11.54 above.

119. See paras.11.33, 11.49 above.

120. See Appendix V, Schedule B, cl.2(g).

121. *Id*., Licence Conditions, cls.5-7.

122. *Id*.. Schedule B, cl.1, 2(a) (1), (o).

123. *Id.*, Schedule B, cl.2(i), (j), (k), (r), (s).

124. *Id*., Schedule 1, Part 2, cl.5.

125. *Id*., Schedule B, cl.2(m).

Appendix I - Terms of Reference

"To enquire into and review the law and practice relating to the legal profession and to consider whether any and, if so, what changes are desirable in

(a) the structure, organisation and regulation of that profession;

(b) the functions, rights, privileges and obligations of all legal practitioners; and

(c) the provisions of the Legal Practitioners' Act, 1898, and the Rules and Regulations made thereunder and other relevant legislation and instruments.

with particular reference to but not confined to the following matters

(d) the division of the legal profession into two branches;

(e) the rights of audience of legal practitioners;

(f) the existence or otherwise of monopolies or restrictive practices within the profession;

(g) the right of senior counsel to appear without junior counsel;

(h) the fixing and maintenance of ethical standards;

(i) the making, investigation and adjudication of complaints concerning the professional competence or conduct of legal practitioners and the effectiveness of the investigation and adjudication of such complaints by professional organisations;

(j) the making, investigation and adjudication of complaints concerning charges made for work done by legal practitioners;

(k) the fixing and recovery of charges for work done by legal practitioners, including the charging by Junior counsel of two-thirds of his senior s fee and the fixing of barristers' fees in advance for work to be done;

(l) the liability of legal practitioners for professional negligence and compulsory insurance in respect thereof;

(m) partnerships and the incorporation of legal practices;

(n) advertising;

(o) confidentiality;

(p) the certification of legal practitioners as specialists in particular fields;

(q) performance of conveyancing and other legal work other than by legal practitioners;

(r) fidelity guarantees and rules relating to the administration of guarantee funds;

(s) the Statutory Interest Account;

(t) the supervision by independent third parties of trust accounts of legal practitioners;

(u) the necessity for participation by legal practitioners in courses of continuing legal education;

but not including an examination of the provisions of the Legal Assistance Act, 1943, the Public Defenders Act, 1969, the Legal Practitioners (Legal Aid) Act, 1970; the role of the Law Foundation; or legal education prior to admission."

Appendix II - Current Solicitors Trust Account Regulations in New South Wales

SOLICITORS TRUST ACCOUNT REGULATIONS

1. (1) These Regulations may be cited as the "Solicitors Trust Account Regulations".

(2) These Regulations shall commence on the first day of July, 1958.

(3) The Solicitors Trust Account Regulations published in Government Gazette No. 8 of 26th January, 1945 are hereby repealed.

1A. In these Regulations -

> “the Act” means the Legal Practitioners Act, 1898.
>
> “trust records” means the books, ledger, statements and journal required to be kept under clause (1) of Regulation 3.

2. (1) These Regulations shall apply to and in respect of every practising solicitor who in the course of his practice as such receives, holds or disburses money on behalf of any person.

Provided that where two or more solicitors are engaged in the practice of their profession in partnership the books, ledger and statement referred to in these Regulations may be kept for or in respect of the transactions of the partnership.

(2) Notwithstanding any other provision of these Regulations other than a provision which expressly or by necessary implication otherwise indicates or requires, nothing in these regulations shall be construed as applying in respect of money that is received by a solicitor and that is not required by the Act to be paid into a bank in New South Wales to a trust account.

2A. Where an account is opened or kept by a solicitor for the purpose of a trust account as referred to in Section 41(1) of the Act, the name of the account shall include the words “Trust Account” or “Trust A/c”.

3. (1) Every solicitor shall keep or cause to be kept at his registered office:-

(a) a receipt book;

(b) a bank deposit book;

(c) a cash book, or receipts cash book and payments cash book;

(d) a trust ledger

(e) a trust cheque book;

(f) trust ledger trial balance statements;

(g) a trust journal.

(2) The receipt book, bank deposit book cash book or books, the trust ledger, the trust cheque book and the trust journal shall be kept either in book form or on the loose-leaf principle or in a system or cards, and provision shall be made for the binding of all loose leaves on or before the last days of the months of March, June, September and December in each year and the filing for record purposes of all completed ledger cards. All trust records shall be retained for a period of five years after the last entry has been made therein.

(3) The receipt book and the cash book or books may be used for the purpose of giving receipts for and recording transactions with any moneys whether or not such moneys are moneys received, held or disbursed for or on behalf of any person, provided separate columns are used for each class of transaction. The bank deposit book, the trust ledger and the trust journal shall be used only in relation to moneys received, held or disbursed by the solicitor for or on behalf of any person. Provided, however, that it shall be permissible for trust transactions to be recorded in a separate column of the bank deposit book, the trust journal and the ledger or on the reverse of a ledger kept on the loose-leaf or card principle.

4. (1) The receipt book shall contain forms of receipt in duplicate and both copies shall be machine numbered, and in such form provision shall be made for entry of the following particulars:-

(a) the date of the receipt;

(b) the amount of the money received;

(c) the name of the person by whom or on whose behalf such moneys paid to the solicitor;

(d) particulars sufficient to identify the transaction in or in respect of which the moneys are paid.

(2) Where moneys are received for or on behalf of any person by a solicitor such solicitor shall issue or cause to be issued from the receipt book a receipt for such moneys, and in such receipt shall enter the particulars referred to in this Regulation. A carbon impression of the receipt and particulars shall be made on the duplicate form and such duplicate form shall be retained.

(3) Where the cash book or receipts cash book is used by a solicitor for the purpose of issuing receipts and a carbon impression of the entry made on the receipt is recorded as a cash book entry -

(a) nothing in clause (1) of this regulation requires that carbon impression in the cash book to be machine numbered if the machine number on the original is recorded as part of the cash book entry by some other process; and

(b) nothing in these Regulations requires the solicitor to keep a separate receipt book.

(4) A solicitor shall clearly mark or cause to be clearly marked on the receipt issued from the receipt book or from the cash book or receipts cash book for moneys received for or on behalf of any person by the solicitor either the words "Trust Account" or the word and symbols "Trust A/c".

(1) The bank deposit form shall make provision for entry of particulars indicating the date of the deposit the amount of the deposit, whether the same consists of cheques, notes or coins, as the case may be, and in the case of cheques the name of the drawer. A carbon impression of the deposit slip shall be made on the duplicate form and such duplicate form shall be retained.

(2) Every solicitor shall ensure that the bank deposit book is produced to the bank at the time of making the deposit and that the particulars referred to in this Regulation are entered therein and that the carbon duplicate of each complete deposit entry is initialled by an officer of the bank and stamped with the bank's stamp.

(1) The cash book shall be a book or books, the sheets of which are consecutively numbered, and the consecutive number of receipts issued or cheques drawn shall be shown on the respective sheets. Where the loose-leaf principle is used, separate sheets maybe kept for the receipts cash book and the payments cash book, and it shall not be necessary to number the sheets consecutively. The solicitor shall enter or cause to be entered on the receipts

side of the cash book or on the receipts cash sheets or in the receipts cash book particulars of all moneys received by him for or on behalf of any person and on the disbursement side of the cash book or in the payments cash sheets or in the payments cash book particulars of moneys disbursed by him for or on behalf of any person.

(2) At the end of each month the cash book or books shall be balanced and the balance carried forward to the commencement of the next month, provided however that such balance may be carried forward on a ledger account provided for that purpose.

(3) At the end of each month the entries in the cash book or books relating to moneys received or disbursed for or on behalf of any person which have been paid into or withdrawn from the trust account shall be compared with the bank pass book or pass sheets and amounts credited to the bank account and appearing in the bank pass sheets for which no receipt had been written and amounts debited to the bank account and appearing in the bank pass sheets for which no cheque had been drawn, shall been entered in the cash book or books.

Any necessary reconciliation showing the balance in the trust account as indicated in the bank pass book or pass sheets, and adding thereto any moneys received but not banked and deducting therefrom cheques drawn on the trust account but not presented for payment shall be entered in the cash book or one of the cash books as the end of the entries for that month.

6A. The solicitor shall enter or cause to be entered in the trust journal particulars of:-

(a) all adjustments to be made to accounts in the trust ledger;

(b) all transfers to be effected from one ledger account to another;

(c) all other transactions affecting any trust ledger account which are not posted or to be posted from a cash book to the trust ledger.

In each entry such particulars shall be sufficient to identify the transaction in respect of which such entry is made and the reason for such entry.

7. (1) The trust ledger shall contain particulars of all moneys held, received or disbursed for or on behalf of any person by the solicitor, which taken in conjunction with other particulars occurring in the receipt book, cash book or books and the trust journal are sufficient to identify the transaction in or in respect of which the moneys are so held, received or disbursed.

(2) Entries in the cash book or books relating to moneys held, received or disbursed for or on behalf of any person shall be posted to the appropriate account in the trust ledger and against each Such entry there shall be recorded a reference to the folio of the cash book from which the entry is posted, or a reference to the receipt number or cheque number where the cash book is kept on the loose-leaf principle.

(2A) Each entry in the trust journal shall be posted to the appropriate account in the trust ledger, and against each entry so posted in the trust ledger there shall be recorded a reference to the folio of the trust journal from which the entry is posted preceded by the letter “J”.

(3) Each account in the trust ledger shall be in the name of the person for whom or on whose behalf the moneys are held.

(3A) At the end of each month each account in the trust ledger shall be balanced and the balance carried forward to the commencement of the next month.

(4) Within one month after the last day of each of the months of March, June, September and December in each year a trial balance statement as at such last day shall be prepared and the date on which the statement is so prepared shall be endorsed thereon. In such statement the balances in the various accounts contained in the trust ledger shall be listed, and such accounts shall be referred to by the name of the person and the folio or other reference to the trust ledger. The result of the trial balance shall be compared with the balance in the cash book or books reconciled with the bank pass book or pass sheets in accordance with the provisions of clause (3) of Regulation 6.

8.(1),(2) (Deleted).

(3) Subject to clause (4) of this Regulation, an applicant for a practising certificate shall forward to the Society with his applicant or within such time after forwarding his application as the Council may in any particular case allow a report in or to the effect of Form No.1 in the Schedule to these Regulations, of a public accountant registered under the Public Accountants Registration Act, 1945.

(4) This Regulation shall only apply to and in respect of a solicitor who in the course of his practice as such either alone or in partnership has received, held or disbursed any moneys for or on behalf of any person during the year ending on 31st March immediately preceding the date on which the application for a practising certificate is made.

(5) Where an applicant for a practising certificate has forwarded to the Society a report of an accountant under clause (3) of this regulation

(a) The Council may require the applicant to furnish a report of another public accountant registered under the Public Accountants Registration Act 1945, and may, if it thinks f' nominate such other accountant;

(b) the applicant, if he is so required, shall forward to the Society a report, in or to the effect of Form No. I in the schedule to these Regulations, of such other accountant; and

(c) the cost of the report forwarded under this clause shall be borne by the Council unless the report so forwarded discloses that the applicant is in breach of or default under any of the provisions of the Act or the Regulations under the Act.

SCHEDULE

Form No. 1

LEGAL PRACTITIONERS ACT, 1898

Solicitors Trust Account Regulations

Regulation 8

TO: THE LAW SOCIETY OF NEW SOUTH WALES

REPORT OF ACCOUNTANT*

Name of Applicant for Practising Certificate:.....

Name of Partnership (if any) of which Applicant is a member:.....

*This report is required in respect of every solicitor who, in his practice as suck either alone or in partnership, has received held or disbursed any monies for or on behalf of any person during the year ending on 31st March immediately preceding the date on which the application for a practising certificate is made. Where solicitors are practising in partnership this report may refer to the accounts of the partnership.

1. Subject to any qualifications contained in clause 2 hereof:-

(a) I have inspected the trust records (as defined in Regulation IA of the Solicitors Trust Account Regulations) of the said applicant/ partnership which the applicant has produced to me and states are kept at his registered office as the trust records (as so defined) in connection with the trust account of the said applicant/partnership relating to transactions during the year ended on the 31st day of March immediately preceding this report.

(b) In my opinion the said trust records are of the nature and in the form prescribed by Regulations 3,4,5,6,6A and 7 of the said Regulations. The said trust records appear to have been regularly written up and properly kept.

(c) I have had produced to me a cash book or books containing what purports to be a reconciliation of the balance, as at 31st day of March immediately preceding this report, shown in such cash book or books with the balance in the bank pass book or pass sheets as required by Regulation 6(3) of the said Regulations. I have also had produced to me such bank pass books or pass sheets and the balance shown therein agrees with that shown in the reconciliation statement.

(d) I have had produced to me statements which purport to be trial balance statements as at the last day of each of the four quarters immediately preceding this report and which are in a form complying with Regulation 7(4) of the said Regulations. In respect of the statement as at the 31st day of March immediately preceding the year or the part of the year in respect of which the applicant is .applying for a practising certificate the totals in such trial balance statement when compared with the reconciliation statement referred to in paragraph (c) of this clause purport to show that the said trust account was in balance at the last mentioned date.

(e) There are no debit balances in any of the trial balance statements referred to in paragraph (d) of this clause other than those which have been satisfactorily explained to me.

(f) I have made an examination of the additions of not less than ten accounts in the trust ledger (or of all such accounts where there are not more than ten) and the balance in each of these accounts as at the 31st day of March referred to in paragraph (d) of this clause agrees with the corresponding balance shown for the same account in the trial balance statement as at the same date.

(g) I certify that:-

(i) The bank/s holding the trust account/s of the said applicant/ partnership has/have affirmed to me that at the close of business on

31st March immediately preceding this Report the number/s and balance/s of the letter/s of credit issued to the applicant/partnership in respect of deposits made to The Law Society of New South Wales Special Account with that bank/those banks were as specified below; and

(ii**)** to the best of my knowledge and belief the total amount specified below was the sum required by Section 42A of the Legal Practitioners Act, 1898, to be on deposit with The Law Society of New South Wales in respect of the applicant/ partnership on that day.

Name of Bank	**Letter of Credit** **Number - Balance**
Australia and New Zealand Banking Group Limited	
Bank of New South Wales	
Bank of New Zealand	
Banque Nationale de Paris	
Commercial Banking Company of Sydney Limited	
Commercial Banking of Australia Limited	
Commonwealth Banking Corporation	
National Bank of Australasia Limited	
Rural Bank of New South Wales	
The Bank of Adelaide	
Other (Specify)	
	Total amount$

+2. I am unable to report in terms of paragraph (a),(b),(c),(d),(e),(f) or(g) of clause 1 except with qualifications as follows:-

+ Delete if not applicable.

Here should be set out any qualifications to paragraph (a), (b), (c), (d), (e), (f), or (g) of clause 1.

Dated this ..... day of .....
1984

(Signed):
.....

Full Name:
.....

(BLOCK LETTERS)

Firm Name: (if any)
.....

Address:.....
.....

Phone No.:
.....

Registered under the Public Accountants Registration Act, 1945.

Appendix III - Law Society's Proposed Solicitors Trust Account Regulations

In this Appendix we reproduce a draft set of Solicitors Trust Account Regulations which the Law Society of New South Wales proposes should replace the current Regulations.

1. (1) These Regulations may be cited as the "Solicitors Trust Account Regulations, 19__ "

(2) These Regulations shall commence on the _____ day of _____ 19___

(3) The Solicitors Trust Account Regulations in force at the commencement of these Regulations are hereby repealed.

2. In these Regulations, unless the contrary intention appears:

“The Act” means the Legal Practitioners Act 1898;

“Approval”, or "Approved" means the written or published approval of the Society;

"Branch Office" means a Solicitors’ Practice Rules;

“Client” means a person or body from whom or on whose behalf Trust Moneys are received held or disbursed;

"Duplicate" includes in relation to any Trust Records; any record containing details identical to the original details of such record, including the machine number, produced by the same act of creating such original records;

“Files” means any documents, correspondence or papers relating to any Client or Clients;

“Machine Numbered in Series” means a process of consecutive numbering of a sequence of a Trust Record other than by hand and independently of the creation of such record;

"Registered Office" means the Solicitor’s registered office referred to in the Solicitors' Practice Rules;

"Trust Moneys" means moneys referred to in Section 41 of the Act, and includes all moneys held in any trust bank account;

"Trust Records" means Approved records of:

(a) receipts;

(b) bank deposits;

(c) cheques;

(d) bank statements;

(e) daily receipt and cheque transactions;

(f) ledger account journal transfers and adjustments;

(g) ledger transactions;

(h) ledger trial balance statements;

(i) Trust Security Investment Authorities; Securities Register;

(k) all minute books and records of the Solicitor’s Nominee Company;

for transactions involving Trust Moneys;

“Trust Security” means a mortgage, charge, security, bill of sale, loan contract, (whether evidenced in writing or not) or any document purporting to secure or regulate the repayment of moneys or any deposit of money held by or under the control of the Solicitor for or in trust for any other person.

“Visible Form” means any record of information whereby the information can be produced in permanent legible form on demand.

3.(1) These Regulations shall apply to every Solicitor who practises his profession in the course of which practice Trust Moneys or Trust Securities are received, held or disbursed by him or by any partnership of which he is a member.

(2) Every Solicitor shall keep, or cause to be kept, at his Registered Office, Trust Records in visible form.

(3) Any Solicitor may in respect of any Branch Office conducted by him and notified to the Society keep or cause to be kept separate Trust Records for that Branch Office, provided that he causes his trust records as a whole to include a consolidated ledger trial balance statement in accordance with (mutatis mutandis) Regulation I I as at the last day of March and September.

(4) All Trust Records shall be retained for six years after the last entry.

4. (1) Receipts shall be in Duplicate, shall be Machine Numbered in Series, shall contain either the words “Trust Account” or the word and symbol “Trust A/C”, and shall include provision for the entry of:

(a) the date of receipt;

(b) the amount of money received and the form in which it is received;

(c) the name of the person from whom and on whose behalf such moneys are received by the Solicitor; and

(d) particulars sufficient to identify the transaction and ledger account in respect of which the Trust Moneys are received.

(2) A receipt containing the particulars described in Clause (1) of this Regulation shall, as soon as practicable, be made out in respect of all Trust Moneys received by a Solicitor (excluding all transfers by journal entry).

(3) The original of such receipt shall be issued on demand, and if not so issued shall be retained.

5.(1) A bank deposit record shall include provision for the entry of:

(a) the date of the deposit;

(b) the amount of the deposit;

(c) whether the deposit consists of cheques, notes or coins (as the case may be); and

(d) in the case of cheques, the name of the drawer, bank branch and the amount of each cheque.

(2) Every Solicitor who, by himself or his partner, makes or causes to be made a deposit to his trust bank account, shall ensure that:-

(a) a bank deposit record is produced to the bank at the time of making a deposit;

(b) the particulars referred to in clause (1) of this Regulation are entered therein; and

(c) a Duplicate or summary of each such bank deposit record is authenticated by an officer of the bank and is retained by the Solicitor as a Trust Record.

6.(1) Trust Moneys shall not be drawn from a Solicitors trust bank account other than by cheque.

(2) Each such cheque shall:

(a) be Machine Numbered in Series;

(b) include a crossing (general or special) and the words "not negotiable";

(c) not be payable to cash;

(d) contain either the words "Trust Account" or the word and symbol "Trust A/c";

(e) be signed by;

(i) the solicitor;

(ii) his partner or

(iii) a person having Approval so to sign; and

(f) include provision for the entry of:

(i) the date of issue;

(ii) the payee; and

(iii) the amount of the cheque.

(3) A record shall be kept of each cheque and such record shall include:

(a) details identifying the ledger account to be debited;

(b) brief particulars of the subject matter or purpose for which the disbursement is made; and

(c) the particulars specified in paragraph (o of clause (2) of this Regulation.

7. Every Solicitor shall keep:

(a) A record of daily receipt and payment transactions in the nature of a cash book; or

(b) As part of the Duplicate or summary required by paragraph;

(c) or Clause (2) of Regulation 5, a record of daily cash (as distinct from cheque) receipt transactions containing particulars of:

(i) the date;

(ii) the amount; and

(iii) the identity of each transaction

8. (1) All transfers between accounts in the ledger not effected by cheque shall be recorded in a journal.

(2) A journal record shall contain such particulars as shall be sufficient to identify each such transaction and the reason for such transaction, including the names of all ledger accounts to be debited or credited, and the relevant reference number of other identification

9. (1) A separate ledger account shall be maintained for each matter for each Client in respect of Trust Moneys.

(2) Each ledger account shall include:

(a) the name of the Client;

(b) a reference number or other identification;

(c) particulars of all transactions affecting Trust Moneys relating to such matter, including;

(i) the date of each transaction;

(ii) a description of each transaction;

(iii) particulars sufficient to identify the Trust Record originating each transaction;

(iv) the amount of each transaction; and

(v) the resulting current balance of account arising from each transaction.

10. (1) A Solicitor who has received trust moneys shall as soon as practicable after completion of the matter in respect of which the trust moneys were received and at any time upon request of the client furnish to the client a Statement of Account showing therein or by reference to any other Statement of Account particulars of all trust moneys:

(a) received by the Solicitor from the client;

(b) received by the Solicitor from any person other than the client;

(c) disbursed by the Solicitor and

(d) remaining undisbursed.

(2) A Solicitor who has acted for a client in the investment upon loan of any Trust Moneys shall in addition to any requirement under Clause (1) of this Regulation and as soon as practicable, after payment of such moneys to the borrower, or to any other person on behalf of the borrower or in accordance with the borrower s direction furnish to the client a written statement signed by the Solicitor and recording the particulars referred to in paragraphs (a) to (k) of clause (2) of Regulation 15 hereof.

(3) A copy of every statement furnished under this Regulation shall be retained in the file relevant to the transaction

11. (1) A trial balance statement of all ledger accounts shall be prepared within twenty-one days after the last day of each month, effective as at such last day.

(2) A trial balance statement shall:

(a) state the month to which it refers and the date of preparation;

(b) list every ledger account by name of Client, reference number or other identification and balance of account at the end of such month;

(c) show the total of the ledger account balances;

(d) show a comparison between such total and the amount of Trust Moneys held by the Solicitor at the end of such month including a reconciliation with the bank balance as at that date as shown in the bank statements.

12. (1) Subject to clause (2) of this Regulation, a Solicitor applying for a certificate shall forward to the Society with his practising application or within such time after forwarding his application as the Council may in any particular case allow, a report in or to the effect of Form No. I in the Schedule to these Regulations, of a public accountant registered under the Public Accountants Registration Act, 1945.

(2) Where an applicant for a practising certificate has forwarded to the Society a Trust Account Report under clause (1) of this Regulation:

(a) the Council may require the applicant to furnish a report of another public accountant registered under the Public Accountants Registration Act 1945 and may, if it thinks fit, nominate such other accountants;

(b) the applicant, if he is so required, shall forward to the Society a report, in or to the effect of Form No. I in the Schedule to these Regulations, of such other accountant; and

(c) the cost of the report forwarded under this clause shall be borne by the Council unless the report so forwarded discloses that the applicant is in breach of or default under any of the provisions of the Act or the Regulations under the Act.

13. (1) A Solicitor may operate a Solicitors nominee company only as provided in these Regulations.

(2) A Solicitors nominee company shall be constituted whereby the Solicitor and his partners shall be the only shareholders and directors-, provided that, in the case of a sole practitioner:

(a) the Solicitors nominee company shall have an issued capital of not less than five shares all of which shall be of the same class and rank parri passu;

(b) the Solicitor shall be the holder of all but one of the issued shares in the Solicitors nominee company and shall be the beneficial owner of the remaining share;

(c) the Solicitor shall be a director of the Solicitors nominee company;

(d) the Solicitors nominee company shall have two directors only and shall have Articles of Association which provide inter alia that:-

(i) the quorum for meetings of directors shall be two;

(ii) in the case of an equality of votes at any meeting of directors the Solicitor shall have a second or casting vote;

(iii) no director shall be entitled to appoint an alternate director or an Attorney to act in his place;

(iv) no shareholder shall be entitled to appoint a proxy.

(3) The Solicitors nominee company shall have its registered office at the Solicitors registered office.

(4) The Society may at any time:

(a) certify that a person or class of person shall not be eligible to be a shareholder or a director of a Solicitor's nominee company and no such person or class of person shall thereafter act as a shareholder or a director thereof.

(b) approve a person who shall be eligible to be a shareholder and/or director of a Solicitor's nominee company.

(5) A Solicitor's nominee company shall not carry on any activity other than the activity from time to time as a trustee of holding and/or dealing with property for another person or persons.

(6) The solicitors nominee company shall not receive directly or indirectly any financed benefit from the activities of the solicitor s nominee company as described.

(7) Every trust security shall be approved by the board of the Solicitor's nominee company and the Solicitor shall ensure that the resolution of the Solicitor's nominee company approving a trust security as recorded in the minute book sets out so far as are relevant the following particulars:

(a) date of the Trust Security or date of receipt of the Trust Security by the Solicitor;

(b) brief description of the Trust Security to enable it to be readily identified, or alternatively a statement that the loan is unsecured;

(c) principal sum;

(d) rate of interest and time of payment;

(e) term of Trust Security;

(f) name and address of the borrower;

(g) name and address of the person on whose behalf the Trust Security is expressed to be made;

(h) name and address of the person if any, in whose favour the trust security is expressed to be made;

(i) date when the Trust Security is discharged or delivered out of the Solicitor’s possession and control (other than upon discharge thereof including reference to evidence of the disposal;

(j) amount contributed by each contibutory to the Trust Security.

(8) In respect of each transaction the Solicitor shall upon loan of any trust moneys, as soon as practicable after payment of such loan to the borrower or in accordance with the borrowers directions, give to the client a written statement signed by the Solicitor containing the information referred to in Clause (7) of this Regulation.

(9) (a) All Trust Moneys advanced on behalf of clients in any Trust Security in the name of the Solicitors nominee company and each repayment of such moneys shall be paid from and received into the Trust Bank Account.

(b) There shall be recorded by journal entry:

(i) The advance from the clients trust ledger account to the trust ledger account of the Solicitor’s nominee company; and

(ii) Each repayment (including any moneys received in connection with such Trust Security) from the trust ledger account of the Solicitor's nominee company to the clients trust ledger account.

14. A Solicitor shall obtain the prior written authority of the Lender or each Contributor, as the case requires, in or to the effect of Form 2 or Form 3 in the Schedule to these Regulations before any moneys are advanced under a Trust Security to which Regulation 15(1) applies, or where the borrower is related to the Solicitor, directly or indirectly.

15. (1) Every Solicitor who is authorised to collect principal and/or interest under any Trust Security (except on any discharge or partial discharge thereof or takes a transfer of any Trust Security into his own name or that of a Solicitor’s nominee company of which he is a member and/or director shall keep a register to be known as the Securities Register.

(2) Every such Solicitor shall enter into the Securities Register:

(a) date of the Trust Security or date of receipt of the Trust Security by the Solicitor;

(b) brief description of the Trust Security to enable it to be readily identified, or alternatively a statement that the repayment of the moneys is unsecured;

(c) principal sum;

(d) rate of interest;

(e) date interest due;

(f) date of maturity;

(g) name and address of the borrower;

(h) name and address of the person, if any, in whose favour the Trust Security was discharged or delivered out of the Solicitor's possession and control;

(i) name and address of the person if any, in whose favour the Trust Security is expressed to be made;

(j) date when the Trust Security was discharged or delivered out of the Solicitor’s possession and control;

(k) Brief details of disposal of the Trust Security on leaving the Solicitor’s possession and control (other than upon discharge thereof including reference to evidence of the disposal;

provided that no entry in the Securities Register shall be required in respect of:-

(l) any Trust Security received by the Solicitor for collection and conversion into money and which money is required to be the subject of a trust account receipt; or

(m) a sealed packet which is handed to a Solicitor for safe custody only.

16. A bona fide delegation in writing by a solicitor of his authority to sign any cheque or cheques to be drawn on a trust account maintained by him or his firm in pursuance of the provisions of Section 41 of the Act shall not of itself be deemed to be professional misconduct if the delegation is not contrary to or inconsistent with any provision express or implied, of any relevant trust and, if the solicitor is practising on his own account or there is no solicitor with whom he is practising in partnership able to sign such cheques with due expedition

(A) the delegation to sign such cheques is to

(i) any two of the following person:

(a) a solicitor holding a current practising certificate;

(b) a public accountant registered under the Public Accountants Registration Act, 1945;

(c) a bank manager; or

(ii) to any other person approved of or nominated by the Council of the Law Society of N.S.W. and

(B) is for a period during which the solicitor is, by reason of illness, injury or absence for legitimate reason from his place of business, unable to sign such cheques with due expedition and

(C) is notified forth within writing to the Secretary of the Law Society of New South Wales and

(D) does not operate or purport to operate when a person with whom the solicitor is practising in partnership is able to sign such cheques with due expedition.

17. Any delegation by a solicitor of his authority to sign any cheque or cheques drawn on a trust account which is maintained by him in pursuance of the Provisions of Section 41 of the Act may be cancelled by the Council of the Law Society of New South Wales at any time and without notice to the solicitor and such cancellation shall be effective from the time it is communicated to any person who is authorised by the delegation to sign any such cheque or cheques.

FORM NO.1

LEGAL PRACTITIONERS ACT, 1898

Solicitors' Trust Account Regulations

Regulation 12

TO: THE LAW SOCIETY OF NEW SOUTH WALES

TRUST ACCOUNT REPORT

(by prescribed Accountant)

Name of Applicant for Practising
Certificate:.....

Name of Partnership (if any) of which Applicant is a member:
.....

1. Subject to any qualification in clause 2 hereof:-

(a) I have inspected or caused to be inspected the trust records (as defined in the Solicitors' Trust Account Regulations) of the said applicant/partnership which the applicant has produced and states are kept at his registered office as the trust records (as so defined) in connection with the trust account of the said applicant/partnership relating to transactions during the year ended on 31 st day of March immediately preceding this report.

(b) In my opinion the said trust records are of the nature and in the form prescribed by the said Regulations. The said trust records appear to have been maintained and kept in accordance with the said Regulations.

(c) The records include what purport to be ledger trial balance statements as at the last day of each of the twelve months ending on 31st day of March immediately preceding this report and which are in a form complying with the said Regulations. The ledger trial balance statement as at 31st March immediately preceding this report purports to show that the trust account was in balance at such date. The balance shown therein agrees with the balance shown in the bank statements and/or other related records.

(d) Other than any deposits made pursuant to Section 42A of the Legal Practitioners Act, 1898:

(i) There are no debit balances in any of the ledger trial balance statements referred to in paragraph (c) of this clause;

OR

(ii) The inspection revealed (No.)..... debit balances which were investigated and which have been satisfactorily explained to me.

(e) Having regard to the internal controls in operation, an examination was made of the additions of an appropriate number of accounts in the trust ledger (being not less than twenty or of all such accounts where there are not more than twenty) and the balance in each of those accounts as at the 31 st day of March referred to in paragraph (c) of this clause agrees with the corresponding balance shown for the same account in the ledger trial balance statement as at the same date.

(f) (i) The bank/s holding the trust account/s of the said applicant/ partnership has/have affirmed to me that at the close of business on 31st

March immediately preceding this report the number/s and balance/s of the letter/s of credit issued to the applicant/partnership in respect of deposits made to The Law Society of New South Wales Special Account with that bank/those banks were as specified below; and

(ii) to the best of my knowledge and belief the total amount specified below was not less than the sum required by Section 42A of the Legal Practitioners Act, 1898, to be on deposit with The Law Society of New South Wales in respect of the applicant/partnership on that day.

Name of Bank	**Number**	**Balance**	**Letter Credit**
Australia and New Zealand Banking Group Limited			
Bank of New South Wales			
Bank of New Zealand			
Banque Nationale de Paris			
Commercial Banking Company of Sydney Limited			
Commercial Bank of Australia Limited			
Commonwealth Trading Bank of Australia			
National Bank of Australasia Limited			
Rural Bank of New South Wales			
The Bank of Adelaide			
Other (specify)			
		Total amount	**$**

2. I am unable to report in terms of paragraph (a), (b), (c), (d), (e) or (f) of clause 1 except with qualifications as follows:-

3. I am aware that The Law Society of New South Wales will rely upon the contents of this report when issuing a practising certificate to the said applicant.

Dated this ..... day of .....
1984

(Signed):
.....

Full Name:
.....

(BLOCK LETTERS)

Registered under the Public Accountants Registration Act, 1945.

Firm Name: (if any)
.....

Address:.....
.....

Phone No.: .....

Appendix IV - Registers of Mortgages, Securities and Investment in Victoria

In this Appendix we reproduce the principal legislative provisions relating to registers of mortgages, securities and investments in Victoria.

Mortgage Register and Nominee Company Rules 1977

1. These rules do not apply to any Mortgage of which the Solicitor is the beneficial owner or to any Mortgage held by any Solicitor or a Corporation in his or its capacity as the trustee of any Will or settlement or to any Mortgage which when executed or transferred will be so held.

2. For the purposes of these Rules:-

> “Contributor” means any person who lends or proposes to lend moneys on the security of a Contributory Mortgage arranged by a Solicitor.
>
> "Contributory Mortgage" means a Mortgage to secure moneys lent by two or more persons. Two or more persons lending on joint account shall for the purpose of these Rules be regarded as a single person.
>
> “Mortgage” means a mortgage, charge, security, bill of sale, loan contract or any document purporting to secure or regulate the repayment of moneys.
>
> “Lender” and “Borrower” mean as the context requires the person to whom and the person by whom any moneys are payable or repayable pursuant to any Mortgage.
>
> “Mortgage Register” means a register maintained for the purpose of these Rules containing the particulars specified in Schedule 2.
>
> "Nominee" means a Solicitor or a Solicitor’s Nominee Company in whose name a Mortgage or Contributory Mortgage is held.

"Person" includes a corporation.

“Solicitor” has the same meaning as in Rule 2 of the Solicitors(Audit and Practising Certificates) Rules.

“Solicitor’s Nominee Company” means a corporation each of the members and each of the directors of which is a solicitor or other person first approved by the Council of the Law Institute.

3. Where a Solicitor’s Nominee Company holds any property as a nominee or trustee for another person a Solicitor who is a member or director of that Company shall not:-

(a) permit any person to become a member or director of that Company unless that person is a Solicitor or other person first approved by the Council of the Law Institute; or

(b) permit that Company to undertake any other activity.

4. (1) Every Solicitor who:-

(a) prepares a Mortgage, the principal or interest of which is to be collected by that Solicitor; or

(b) is authorised to collect the principal or interest under any Mortgage, except on any discharge or partial discharge of the Mortgage; or

(c) takes a transfer of Mortgage to himself or prepares a transfer thereof to a Solicitor’s Nominee Company of which he is a member or director;

shall keep a Mortgage Register and shall enter in that Mortgage Register the particulars specified in Schedule 2 within one month after:-

(d) the date on which the first loan under the Mortgage is made; or

(e) the date on which the Mortgage becomes one to which this Rule applies

whichever date last occurs.

(2) For every other Mortgage held in the name of a Nominee the same particulars as are required to be entered in such Register by sub-rule (1) of this Rule shall be entered in the Mortgage Register of:-

(a) the solicitor who is such Nominee; or

(b) the solicitor who is the director or one of the directors of the Solicitor's Nominee Company which is such Nominee,

as the case requires.

(3) Every Solicitor who prepares a variation of any Mortgage to which sub-rule (1) or sub-rule (2) of this Rule applies shall, within one month thereafter, enter in the Mortgage Register such of the particulars specified in Schedule 2 as may in the circumstances be necessary, in consequence of such variation to maintain the accuracy of the Mortgage Register.

10. (1) In respect of every Mortgage to which Rule 4 applies the Solicitor shall within one month after the date of

(a) the first advance under the Mortgage; or

(b) the transfer of the Mortgage; or

(c) being authorised to collect the principal and interest except on any discharge or partial discharge of the Mortgage; or

(d) any variation of such Mortgage

prepare and execute a Summary of Mortgage containing the particulars specified in Schedule 2 and in the case of a Nominee Mortgage shall prepare and execute a Declaration of Trust. The original Summary of Mortgage and Declaration of Trust shall be retained by the Solicitor and within the said period of one month copies shall be forwarded to the Lender and in the case of a Contributory Mortgage to each Contributor.

(2) Where there is any change of Contributors the Solicitor shall within one month after that change prepare, execute and supply to any new Contributors a Summary of Mortgage containing the particulars specified in Schedule 2 and in the case of a Nominee Mortgage prepare and execute a Declaration of Trust The original Summary of Mortgage and Declaration of Trust required by this sub- rule shall be retained by the Solicitor and within the said period of one month copies shall be forwarded to each new Contributor.

Solicitors (Audit and Practising Certificates) Rules 1965

28. Every solicitor shall keep a register, to be known as the register of securities, in which he shall cause to be entered in respect of -

(a) all securities for money, the title to which is transferable by delivery, held by the solicitor for or on behalf of or in trust for other persons (excluding such negotiable securities as are received for immediate collection and conversion into money and are the subject of a trust account receipt and are entered on receipt thereof in a trust account cash book); and

(b) all securities and documents of title held by the solicitor in his own name or in the joint names of the solicitor and some other solicitor or solicitors for or on behalf of or in trust for any other person or persons

the following particulars -

(a) the date of receipt of the security by the solicitor;

(b) the description of the security, including the principal sum purporting to be secured thereby;

(c) the name of the person for whom or on whose behalf or in trust for whom the security is held;

(d) the name of the person, if any, in whose favour the security, if negotiable, is expressed to be made;

(e) the date on which the security is delivered out of the solicitor's possession and control; and

(f) a short narration of the disposal of the security on leaving the solicitor s possession and control.

29. The entries referred to in paragraphs (a) to (d) of the last preceding rule shall be made forthwith upon the receipt by the solicitor of the security and the entries referred to in paragraphs (e) and (o of the said rule shall be made forthwith upon the delivery of the security out of the solicitors possession and control

29A. The register of securities, register of investments and mortgage register shall form part of the solicitor's trust accounts within the meaning of Rule 16 hereof and shall be subject to audit accordingly.

30. Every solicitor shall retain every volume of his register of securities, register of investments and mortgage register for at least two years after the date of the last disposal entry made therein.

30A. (1) Every solicitor shall keep a register to be known as the register of investments, in which he shall record, or in which he shall cause to be recorded, details of every investment of trust monies for or on behalf of any person for which there is no security held by the solicitor which is required pursuant to Rule 28 to be entered in the register of securities;

(2) The details to be entered in the register of investments shall include in relation to each investment:-

(a) the name of the person for whom the investment is made;

(b) the amount invested;

(c) the date upon which the investment is made;

(d) description of the investment;

(e) details (including the cheque number or other means of identification) of the payments whereby the investment is made sufficient to identify the payment in the trust books of account;

(f) a statement as to whether any certificate or other document evidencing the investment or security therefor is held by the solicitor, and

(g) when the investment matures or is realised and the proceeds are received by the solicitor for or on behalf of any person a reference to the cash receipt record in the trust books of account.

Appendix V - Queensland Legislation Relating to Summaries and Registers of Investments

We reproduce below the principal legislative provisions in Queensland relating to summaries and registers of investment transactions.

Queensland Law Society Rules

R68F (3) Where a practitioner prepares a document securing or evidencing a loan by more than one individual that practitioner must deliver to each lender before the loan is made a statement by the practitioner specifying the following and must obtain from each lender an acknowledgement of receipt and an authority to make the loan in accordance with that statement:-

(i) A statement that the loan is a contributory one and consequently that every lender cannot himself hold the document and that a lender cannot without the approval and co-operation of his co-lenders exercise any remedy if the borrower defaults;

(ii) A statement of the professional and other fees if any and estimated outlays that the practitioner will charge in connection with the negotiation of the loan and in the preparation execution stamping and registration of that loan document;

(iii) A statement that no fee except as disclosed under (ii) will be charged by the practitioner nor will the practitioner or any other practitioner or member of his family or staff participate in such fee if charged by another person;

(iv) A statement containing the following:

The amount to be lent by each lender;

The name and address of each lender;

The total amount of the loan;

The rate of interest;

The terms of repayment including any right to early repayments;

The real property description (if applicable) and address of the property charged;

The amount of any valuation held by the practitioner;

Details of any prior charge;

Special conditions (if any).

(v) A statement that investment in accordance with this authority will waive any claim under the Legal Practitioners' Fidelity Guarantee Fund.

(4) A security document in circumstances of subclause (3) hereof must only be taken in the names of all individuals who are lenders thereunder as tenants in common in their respective interests.

R68G (1) This rule does not apply to any security of which the practitioner is the beneficial owner or to any security held by any practitioner or other party in his or its capacity as the trustee of any will or settlement.

(2) Every practitioner who -

(a) prepares a loan or security document, the principal or interest of which is to be collected by that practitioner, or

(b) is authorised to collect the principal or interest under any loan or security document, except on any discharge or partial discharge of the document,

shall keep a mortgage register and shall enter in that mortgage register the particulars specified in the schedule hereto within one month after-

(i) the date on which the first loan under the loan or security is made; or

(ii) the date on which the loan or security becomes one to which this rule applies,

which ever date last occurs.

(3) Every practitioner who prepares a variation of any loan or security document to which subrule (2) of this rule applies shall, within one month thereafter, enter in the mortgage register such of the particulars specified in the said schedule as may in the circumstances be necessary, in consequence of such variation to maintain the accuracy of the mortgage register.

Schedule

Particulars to be Specified in Mortgage Register

(1) Name and address of lender;

(2) Name and address of borrower;

(3) Amount of principal sum lent;

(4) The date on which the principal sum was lent;

(5) The date or dates on which the principal sum of any part is repayable;

(6) The rate of interest and the dates on which each instalment of interest will fall due for payment;

(7) The security for the payment of the loan in sufficient detail to enable the security to be readily identified and where applicable title particulars or alternatively that the loan is unsecured; and

(8) The registration or dealing number, certificate number or other identification as is relevant.

Appendix VI - Victorian Licensing System for Solicitor's Private Finance Companies

In this Appendix we reproduce the instrument of delegation by the National Companies and Securities Commission which indicates the principal features of the licensing system for private finance companies which was introduced in Victoria in 1984.

PURSUANT to Section 45 of the National Companies and Securities Commission Act 1979 of the Commonwealth and Section 12 of the National Companies and Securities Commission (State Provisions) Act 1981 of the State of Victoria and Section 12 of the National Companies and Securities Commission (State Provisions) Acts 1981 of the States of New South Wales, Queensland, South Australia, Tasmania and Western Australia and all other enabling legislation (if any) the *NATIONAL COMPANIES AND SECURITIES COMMISSION HEREBY DELEGATES* to the *COMMISSIONER FOR CORPORATE* AFFAIRS for the State of Victoria, an officer appointed pursuant to Section 6 of the Companies (Administration) Act 1981 of that State and an officer for the purposes of Section 45 and Section 12 aforesaid, all of those powers and functions conferred or expressed to be conferred on the *NATIONAL COMPANIES AND SECURITIES COMMISSION* by the provisions of the Companies Act 1981 of the Commonwealth and the corresponding laws of the participating States (collectively “the Act”) specified in Schedule A in relation to the persons referred to and on the conditions set out in Schedule B.

SCHEDULE A

(a) the power, pursuant to sub-section 215C(2) or (6), to exempt from compliance with or omit, modify or vary, as the case may be, Part IV Division 6 of the Act;

(b) the power to apply to the Court for an order pursuant to subsection 215C(5) of the Act; and

(c) the function of causing a copy of an instrument to be published in the Gazette in accordance with sub-section 215C(8).

SCHEDULE B

Solicitors Mortgage Investment Companies as defined below:

Conditions of Exemption

1. In these conditions of exemption unless inconsistent with the context or subject matter-

approved investments" means:

Mortgages of interests in land

authorized trustee investments

real property where the total investment does not exceed shareholders' funds and ten per centum of funds deposited with the company

solicitors mortgage investment companies holding a licence under the Securities Industry (Victoria) Code

cash management trusts

such other investments as may be authorized by the Commissioner.

“associated company” with respect to a licensee means a company

(a) the composition of the board of directors of which or

(b) more than half the issued share capital of which is controlled or held by directors or members of that licensee or persons associated with that licensee.

“associated trustee” with respect to a licensee means a person who holds property on trust for a director or member of that licensee or for a person associated with that licensee.

“Commissioner” means the Commissioner for Corporate Affairs established under the Companies (Administration) Act 1981.

"half yearly date" means the last day of June or December in each year or such other half yearly date as the Commissioner may approve.

"interest in land" shall have the same meaning as the expression "prescribed interest' has from time to time in the Housing Loans Insurance Corporation Act 1965.

"licensee" means a Solicitor’s Mortgage Investment Company which has been granted a licence under the Securities Industry (Victoria) Code.

“person associated with a licensee” includes a person who is a partner spouse parent grand parent childchild's spouse grand child or grandchild's spouse of a director or member of that licensee.

“shareholders' funds” means the excess of tangible assets over total liabilities.

"Solicitor’s Mortgage Investment Company” means a company all the directors of which hold full practising certificates under the Legal Profession Practice Act 1958 or are approved by the Commissioner to act as directors, the business or principal business of which is or is intended to be that of borrowing or accepting moneys on deposit and the investment of those moneys mainly on mortgage security.

2. It shall be a condition of each exemption granted that:

(a) the licensee shall not invest funds deposited with it in other than approved investments.

(b) the licensee shall not carry on a business other than a business in accordance with these conditions.

(c) the licensee shall not be a Solicitor’s Nominee Company as defined in the Mortgage and Nominee Company Rules 1977.

(d) the licensee shall not carry on business in trust for any person or persons or hold any property in trust for any person or persons;

(e) each director of the licensee shall hold a full practising certificate under the Legal Profession -Practice Act 1958 or be a person approved by the Commissioner.

(f) each shareholder who has a right to vote at a meeting of the licensee shall be:

(i) a director; or

(ii) the executor or administrator of a deceased shareholder who was a director; or

(iii) a person approved by the Commissioner.

(g) the auditor of the licensee shall be the auditor who audits under the Legal Profession Practice Act 1958 the trust accounts of each director.

(h) the licensee shall within three months of each half yearly date lodge financial statements made up for a period ending on such half yearly date preceding the date of lodging with the Commissioner including a statement setting out the amount and the percentage of funds invested in each category of approved investments.

(i) before the licensee accepts any deposit of money from any person for any separate account with the licensee (other than a licensed Solicitor's Mortgage Investment Company) the licensee shall give to the depositor a duplicate notice in the form of Schedule I hereto completed in both Parts 1 and 2 and shall obtain an acknowledgment in the form of Part 3 thereto signed by the depositor and one copy returned to the licensee.

(j) the licensee shall advise the depositor in writing of any intended changes in the terms or conditions of such deposit at least seven (7) days prior to effecting the change.

(k) at six (6) monthly intervals the licensee shall advise the depositor in writing of the balance of the depositor s account with the licensee including any interest compounded thereon.

(l) no loan shall be made by the licensee except a loan:

(i) which is secured by a mortgage over an interest in land situated in the Commonwealth of Australia in respect of which the principal sum secured together with the aggregate of any other principal sums secured pursuant to any prior mortgages over that interest in land does not exceed whichever is the greater of an amount equal to 70% of the value of the interest in land subject to the mortgage or an amount equal to the amount in respect of which a licensee is insured for repayment of that mortgage under an enforceable policy issued by the Housing Loans Insurance Corporation or other person approved by the Commissioner.

For the purposes of this sub-paragraph the expression "value of the interest in land" means the current capital improved value of that land as fixed by the municipality in which the land is situated or the value of the land as sworn to by a registered valuer within six (6) months of the making of the loan.

(ii) which is secured in such other matter as the Commissioner may in writing approve; or

(iii) which is made for temporary purposes to a person approved in writing by the Commissioner.

(m) no loan shall be made to a director or to a member of a I icensee or to an associated company or an associated trustee without the prior approval in writing of the Commissioner.

(n) no loan shall be made to any person except with the prior approval in writing of the Commissioner if the result would be that the total of all loans made by the licensee to that person would equal or exceed an amount equal to ten per cent of all loans made by the licensee and outstanding;

(o) all mortgages of Interests in land shall (in the case of land situated in the State of Victoria) be registered under the transfer of Land Act 1958 or the Property Law Act 1958 or other enactments which permit the registration of such mortgages and (in the case of land situated in another State or Territory of Australia) be registered under the legislation of that other State or Territory which permits the registration of such mortgages except:

(i) as otherwise permitted by the Commissioner;

(ii) where all moneys secured under a mortgage have been repaid or are required to be repaid to the licensee within ninety (90) days of the making of the loan; or

(iii) where the mortgage is incapable of being registered under the laws of the State or Territory in which the mortgage is granted.

(p) no security shall be given by the licensee over all or any of its property except for stand-by facilities approved by the Commissioner or in such other circumstances as the Commissioner may approve.

(q) the directors of the licensee shall lodge with the Commissioner a duly executed guarantee in a form approved by the Commissioner under which the directors jointly and severally guarantee the due payment by the licensee of all its liabilities from time to time PROVIDED THAT where in the opinion of the Commissioner the non payment by the licensee of a liability in respect of a deposit or interest thereon is caused by the inability of the licensee to enforce a

security because of a moratorium or similar stay imposed by law with respect to that security and the licensee has substantially observed all licence conditions and all legal requirements with respect to that security the Commissioner shall not enforce the guarantee against the guarantors with respect to that liability during the period of that moratorium or stay.

(r) the licensee shall keep a register of mortgages and other investments (herein referred to as the “Security Register”) and enter in that register within one month after the date on which each loan or other investment by the licensee is made:

(i) where the loan is secured by a mortgage, the particulars specified in Schedule II, and

(ii) in any other case, such particulars as may be prescribed by the Commissioner,

PROVIDED THAT if for any substantial reason it is not possible to complete any part of the register within the period of one month the licensee shall complete the register as required omitting the particulars not then available.

(s) the licensee shall keep a Depositor’s Register in which is recorded the name and address of the depositor and the number of his account.

(t) the licensee shall notify the Commissioner in writing within fourteen days of each of the following events:

(i) a change in the directors or voting shareholdings of the licensee;

(ii) a change in the registered office of the licensee.

(u) If a director who has given a guarantee of the obligations of a licensee under paragraph 2(o hereof dies or ceases to be a director of the licensee or ceases to be a shareholder of the licensee the Commissioner may at any time prior to the expiration of twelve (12) months from the date of death or the date of cessation and shall at the expiration of twelve (12) months from such date release him or his personal representatives as the case may be from liability under that guarantee; provided that the Commissioner is satisfied that

(i) either at the date of such death or cessation or at the date that application for release is made the licensee is solvent and is not in breach of any of the prescribed conditions or is in breach but such breach is not likely to affect the solvency of the licensee; or

(ii) in all the circumstances the director or his personal representatives as the case may be ought to be released.

(v) Any release given by the Commissioner under the preceding sub-paragraph shall be given on terms (whether or not expressed in such release) that:

(i) the director named as released (the “retiring guarantee”) shall be released but all the other directors (the "continuing guarantors") shall remain jointly and severally liable as guarantors of the liabilities of the licensee, and

(ii) all rights are reserved against the continuing guarantors and the licensee to the intent that as regards the continuing guarantors and the licensee such release shall operate as a convenant not to require payment from the retiring guarantor.

Schedule I

NOTICE TO DEPOSITOR: (Name and Address of Solicitor's Mortgage

Investment Company) ("the Company")

TO: (Name and Address of Depositor)

PART 1

The particulars of the proposed deposit by you are:

(1) Amount of Deposit;

(2) Date Deposit to be made;

(3) Date Deposit repayable;

(4) Rate of interest;

(5) Dates interest payable.

PART 2:

ALSO PLEASE TAKE NOTE:

1. The company holds a dealer s licence under the Securities Industry (Victoria) Code. Deposits with it are guaranteed personally by its directors who remain liable under such guarantee until they cease to be directors of the company and are released by the Commissioner. A copy of the licence is available on request

2. (name of solicitor or name of firm of Solicitor) has/have an interest in the Company and he/she/they are entitled to participate in the profits of the company.

3. Depositors do not participate in profits of the company and are entitled only to the return of their deposits on the agreed date and the agreed interest payments thereon.

4. The Company intends to invest in the following:

Mortgages of Interests in land Authorized Trustee investments Real property where the total investment does not exceed shareholders funds and ten per centum.

5. The deposit will be a loan to the company and your right of recovery of your deposit and any interest thereon is against the assets of the company. Your deposit is not secured by mortgage, debenture or charge. You may have no recourse to the Solicitors' Guarantee Fund.

6. (Such other matters as are prescribed or permitted by the Commissioner).

PART 3

ACKNOWLEDGEMENT:

I the above Depositor ACKNOWLEDGE:

(1) Receipt of a copy of this Notice.

(2) That the above particulars accord with my understanding of the proposed deposit.

PART 4

Directions as to payment of interest.

Schedule II

Particulars to be specified in Security Register with respect to each investment or advance:

(1) Name and address of borrower.

(2) Amount of principal sum lent

(3) The date of which the principal sum was lent.

(4) The date on which the principal sum is repayable.

(5) The rate of interest and the dates on which each instalment of interest will fall due for payment.

(6) The security for the payment of the loan in sufficient detail to enable the security to be readily identified and where applicable title particulars.

(7) The registration or dealing number, certification number or other specification as is relevant.

(8) Where relevant, insurance particulars of the subject property.

(9) Whether the loan is insured and if so with whom and the number of the relevant policy.

(10) The amount of any valuation of the subject property and the name of the valuer.

(11) Any other. relevant information.

FORM 2

LEGAL PRACTITIONERS ACT, 1898

Solicitors' Trust Account Regulations

Regulation 14

Trust Security Investment Authority

(To be completed and obtained for each Trust Security)

To: (insert name and address of Lenders Solicitor(s))

(1) Total principal sum to be advanced $..... in one lump sum (or by a first advance of $ ..... and, further advances on the following terms:-).

(2) My contribution .....$

(3) Estimated value of security $..... established by (e.g. last sale price and date valuation or opinion of (name) and brief details)

(4) Details of Security:-

(5) Borrower- (Name and address)

(6) Term of loan months/years

(7) Interest rate .....% per annum payable (quarterly/yearly etc.).

(8) Lender- the advance is to be made in the name of:- (Name and address)

(9) The total principal sum Is to be advanced by way of a first mortgage (or by way of a mortgage, or by way of a (insert description of other Trust Security) the amount of $.....being secured by any prior mortgage or other Trust Security).

(10) All correspondence is to be sent to me/us at my/our above address until further notice:-

(11) (Insert any other special conditions or circumstances and additional instructions).

(Where this Authority is provided in relation to a second or subsequent Trust Security the following additional paragraph must be inserted and underlined).

I ACCEPT THAT ANY RIGHTS OF THE LENDER UNDER THIS TRUST SECURITY (WHICH INCLUDES MY RIGHTS) ARE SUBJECT TO AND SECONDARY TO THE RIGHTS OF THE LENDER(S) UNDER ANY PRIOR TRUST SECURITY AS NOTED ABOVE.

(Signatures).....

Lender(s).....

Date.....

NB: If the borrower is related to the Solicitor, directly or indirectly, the Lender ought to obtain independent advice and/or. representation. Details of the obligations imposed on the Solicitor are obtainable from the Solicitor or the Law Society.

FORM 3

LEGAL PRACTITIONERS ACT, 1898

Solicitors' Trust Account Regulations

Regulation 14

General Mortgage Investment Authority

(To be obtained only where a continuing instruction is to be given to a Solicitor to advance moneys on freehold first mortgage investments without the Lender previously specifying any particular first mortgage security).

To: (Insert name and address of Lender's Solicitor(s))

I/We (name and address) confirm my/our instructions to you to advance at your discretion the sum of $..... now held by you on my/our behalf on freehold first mortgage security to be held in the name of (name and address of Nominee) and I/We acknowledge that the loan moneys to be advanced under any such first mortgage may be provided by two or more Contributors (including myself/ourselves) but will not exceed per centum of the valuation of the Security and that as soon as practicable after payment of each such advance you will forward a Summary of the mortgage.

(delete and initial if inapplicable)

I/We do not authorise you to advance the said sum to a borrower who is related to you, directly or indirectly.

All correspondence is to be sent to me/us at my/our above address until further notice.

I/We may cancel this authority at any time by written instructions to you.

(Signatures).....

Lender(s).....

Date.....

NB: A Lender ought to obtain independent advice and/or representation before authorising the Solicitor to advance moneys to a borrower related to the Solicitor. Details of the obligations imposed on the Solicitor are obtainable from the Solicitor or the Law Society.

Licence Conditions

1. The licensee shall not carry on a business other than a business for which an exemption has been granted pursuant to Section 215C of the Companies (Victoria) Code.

2. The licensee shall at all times comply with the conditions of the exemption referred to in condition 1, which apply from time to time.

3. The licence certificate shall upon request be made available for inspection by any person who transacts or intends to transact any business with the licensee.

4. The licensee shall immediately in writing inform the Commissioner for Corporate Affairs of any change in the name, style or manner under which its business of dealing is carried on.

5. The licensee shall ensure that the company’s net tangible assets as defined in Appendix A hereto shall not be less than $50,000.00, or an amount equal to 2.5 per centum of the company’s adjusted liabilities, whichever is the greater.

6. The licensee shall ensure that subject to paragraph (7) hereof not less than 10 per centum of depositors' funds is retained in the following form:-

(a) At least 5 per centum invested in deposits at call or n deposits which will fall due for repayment within 90 days with one or more of the following:

(i) a banking corporation as defined in the Securities Industry (Victoria) Code;

(ii) a corporation that is declared by the Governor in Council by notice in the Government Gazette to be an authorized money market dealer;

(iii) a building society in respect of which there is in force a declaration under sub-section 4(5) of the Trustee Act 1958 as amended by the Trustee (Investments) Act 1981 (or its equivalent), authorizing trustees to make deposits or term deposits with the building society; or

(iv) a cash management trust the trust deed of which has been approved and filed with a Local Authority.

(b) Where the total of the deposits specified in paragraph (a) is less than 10 per centum, the remainder of the 10 per centum is:-

(i) invested in bank- accepted or endorsed bills of exchange;

(ii) placed on loan by registered first mortgage over real estate for a period not exceeding three months and for an amount not exceeding 70 per centum of the valuation of the security as sworn to by a registered valuer within six (6) months of the making of the loan or not exceeding 70 per centum of the current improved value of that land as fixed by the municipality in which the land is situated;

(iii) deposited with a solicitors mortgage investment company holding a licence under the Securities Industry (Victoria) Code and being a deposit due for repayment no later than ninety (90) days from the date of investment; or

(iv) invested in Government or semi-Government securities.

7. The licensee may cause part of the funds that have been invested in compliance with paragraphs 6(a) and 6(b) hereof to be released to repay depositors provided the licensee shall re-establish the fund within ninety (90) days or such further period as the Commissioner may in writing allow and in priority to any other investments.

8. The licensee shall lodge and maintain with the Commissioner for Corporate Affairs an approved security of $20,000.

9. If the licence is revoked or suspended the licence certificate shall be returned to the Commissioner for Corporate Affairs immediately.

NOTES:

A. Sub-clause 18(l) of the Securities Industry (Victoria) Regulations provides:

"For the purpose of section 51 of the Code, a licence is granted subject to a condition that the holder of the licence shall immediately notify the local authority in writing of any matter that may adversely affect the financial position of the holder of the licence."

B. Sub-section 52(1) of the Securities Industry (Victoria) Code provides:

"If an event occurs that constitutes a contravention of, or a failure to comply with a condition or restriction applicable in respect of a licence, the holder of the licence shall, not later than the day after the day on which the event occurred, give notice in writing to the Commission setting out particulars of the event"

APPENDIX A

(1) *Net Tangible Assets*

Net tangible assets shall mean the excess of total tangible assets over total liabilities.

(2) *Total Tangible Assets*

Total tangible assets shall mean the total assets of the licensee adjusted for any exclusions listed below.

(2.2) *Exclusions.*

(a) amounts owing to the licensee, the recovery of which is doubtful,

(b) loans or advances made to:

(i) (1) directors, or immediate families, family companies and trusts of directors of the licensee;

(2) employees or immediate families, family companies and trusts of employees of the licensee;

(3) persons associated with a licensee; or

(4) associated companies or associated trustees

and which are not secured adequately to the satisfaction of the Commissioner for Corporate Affairs provided that loans or advances excluded in their own right shall not be included simply because they are secured by way of a guarantee or an indemnity from a proprietary company;

(c) assets lodged with the Commissioner for Corporate Affairs for the purpose of a security pursuant to Section 51(2) (d) of the Securities Industry (Victoria) Code;

(d) assets to the amount which they have been charged or pledged for the purposes of arranging a security pursuant to Section 51(2) (d) of the Securities Industry (Victoria) Code;

(e) funds available on demand by way of a letter of guarantee,

(f) any asset which may be regarded on the basis of generally accepted accounting principles as being intangible; and

(g) any asset which the Commissioner for Corporate Affairs in writing declares may not be included.

(2.3) *Method of valuation of tangible assets:*

(a) All trading stock and like assets are to be valued at the lower of cost or net realisable value.

(b) All other assets are to be valued at a fair value always providing that all securities, promissory notes and bills of exchange having a ready market are to be valued at a fair value but not in excess of market value.

(3) *Adjusted Liabilities*

Adjusted liabilities shall mean total liabilities less any liability which the Commissioner for Corporate Affairs in writing agrees may be an acceptable deduction from total liabilities.

(4) *Other Definitions*

(4.1) *Associated Person*

The term “person associated with a person” shall have the meaning expressed in the Securities Industry (Victoria) Code.

(4.2) *Secured Adequately*

Loans or advances shall be deemed to be secured adequately if secured by way of a charge, legal or equitable, of a recognised nature over securities for which there exist a ready market provided that the market value of these securities always equals no less than 105 per cent of the said loans or advances.

Loans or advances secured by way of a registered first mortgage over real estate that has a fair market valuation at least equal to the said loan or advance shall be deemed to be secured adequately.

GIVEN under the Common Seal of the *NATIONAL COMPANIES AND SECURITIES COMMISSION* the 13th day of February 1984.

The *COMMON SEAL* of the NATIONAL COMPANIES AND *SECURITIES COMMISSION* hereunto affixed pursuant to a direction of the commission in the presence of: ....

Select Bibliography

The Commission has collected and considered a very extensive range of material in the course of preparing this Report. Almost all of this material is held in indexed files which are available to the public at the Commission's offices.

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Index

This index indicates the recommendation numbers and paragraph numbers in the Report which refer to particular topics. Where recommendation numbers are indicated they refer to the numbered list of recommendations which appears at the beginning of the Report under the title Summary of Recommendations. The Index refers only to the text of the Report It does not refer to the material in the footnotes.