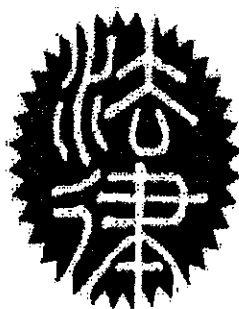


Manual on Solicitors' Accounting



THE

LAW SOCIETY
OF HONG KONG

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Law Society of Hong Kong

Manual on Solicitors' Accounting

This manual is only intended as a general guide on solicitors' accounting system. The formats of the books and records recommended in this manual are for reference only. Each firm should decide for itself a system that best suits its need taking into account its own circumstances.

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1. CLIENT ACCOUNTS

“Compliance with the Solicitors’ Accounts Rules is the equal responsibility of all partners in a firm. They should establish policies and systems to ensure that the firm complies fully with the Rules. Responsibility for day-to-day supervision may be delegated to one or more partners to enable effective control to be exercised. Delegation of total responsibility to a clerk or book-keeper is not acceptable.”

[Paragraph 2(1), Appendix 5, Practice Directions 1990]

1.1 WHAT IS CLIENT ACCOUNTING

Client accounting is a simple form of bookkeeping used exclusively for client transactions. It is the recording by a solicitor of the receipt, payment and transfer of clients’ money, with all transactions being recorded in individual client ledger accounts maintained for the person from or on whose behalf the money was received.

1.2 PRESERVATION OF RECORDS

According to Rule 10(6) of the Solicitors' Accounts Rules, all books, accounts and records showing dealings with clients' money, held received or paid by the solicitor and any other money dealt with by him through a client account must be preserved for at least 6 years from the date of the last entry therein.

“The firm should establish policies and systems for the retention of the accounting records to ensure:

- (a) books of account, reconciliation, bills, bank statements and passbooks are kept for at least six years;*
- (b) paid cheques and other authorities for the withdrawal of money from a client account are kept for at least two years;*
- (c) other vouchers and internal expenditure authorisation documents relating directly to entries in the client account books are kept for at least two years.”*

[Paragraph 5(6), Appendix 5, Practice Directions 1990]

In respect of paragraph (b) above, either photocopies or microfilms of paid cheques will suffice.

According to rule 10(6A) of the Solicitors’ Accounts Rules, all accounting records kept by a solicitor must be kept in Hong Kong.

1.3 CLIENT ACCOUNT RECORDS

Regardless of whether a manual or computerised system is used, the various client account records which a solicitor should keep are as follows:-

- (1) client receipts;
- (2) client cheque requisitions;

- (3) client cash book;
- (4) client bank statements;
- (5) client journal;
- (6) client ledger;
- (7) reconciliations of client accounts;
- (8) bills records;
- (9) transaction files; and
- (10) direct payments register.

1.4 WRITING UP BOOKS AND ACCOUNTS

1.4.1 RELEVANT RULE - RULE 10(1) SOLICITORS' ACCOUNTS RULES

"Every solicitor shall at all times keep properly written up such books and accounts as may be necessary-

- (1) *to show all his dealings with-*
 - (a) *clients' money held, received or paid by him; and*
 - (b) *any other money dealt with by him through a client account; and*
- (2) *to distinguish such money held, received or paid by him on account of each separate client and to distinguish such money from other money held, received or paid by him on any other account."*

1.4.2 CLIENT'S MONEY

Before writing up the client account records, a solicitor must consider if the money dealt with by him is client's money. "Client's money" is defined in Rule 2 of the Solicitors' Accounts Rules as *"money held or received by a solicitor on account of a person for whom he is acting in relation to the holding or receipt of such money either as a solicitor or, in connexion with his practice as a solicitor, as agent, bailee, stakeholder, solicitor-trustee or in any other capacity, but not money to which the only person entitled is the solicitor himself or, in the case of a firm of solicitors, one or more of the partners in the firm"*

Save for cases which fall within any of the exceptions set out in rule 9 of the Solicitors' Accounts Rules, all client's money must be paid into client accounts.

1.4.3 CLIENT RECEIPTS

(a) Form of receipt

The receipt of client money should be documented by the issue of a client receipt. Client receipts should be issued from a pre-printed book of duplicate receipt forms unless a computerised accounting system is used which produces a client receipt and the system has controls that:-

- (1) ensure that receipts are issued in numerical order; and
- (2) prevent a receipt number being used more than once.

Client receipt books should contain receipts in duplicate and should be machine-numbered consecutively. Each duplicate receipt should be printed in identical form to the original receipt, except that the words "office copy" or "duplicate copy" should also appear on the duplicate receipts.

The following headings and particulars should be shown on each receipt:-

- (1) "CLIENT RECEIPT";
- (2) the name of the client on whose behalf the receipt is issued;
- (3) the file number;
- (4) the date of issue;
- (5) the name of the person by whom the payment is made;
- (6) the name of the person on whose behalf the money is received;
- (7) a brief description of the matter for which the money is received;
- (8) the amount of money received in words and figures;
- (9) how the money is received, for example, in cash, by cheque, or by electronic funds transfer;
- (10) provision for the signature of the person issuing such receipt.

Set out below is a sample of a client account receipt:-

ABC & COMPANY	No.: 101
CLIENT RECEIPT	
	File No: _____
	Date: _____
File Name _____	
Re: _____	
Received from _____	
Being \$	_____
\$	_____
\$	_____
\$	_____
Total H.K. \$	_____
By Cash/Telegraphic Transfer	
By Cheque No. _____ of _____	Bank (Note 1) ABC & Company
By Cheque No. _____	Bank (Note 1)
By Cashier Order No. _____ of _____	Bank
Note: 1. Where payment is made by cheque this receipt will not be valid until the cheque has cleared	
	_____ Authorized Signature

(b) Issue of client receipts

When client money is received, a client receipt should be issued immediately. The receipt should be signed, not merely initialed, and should be dated with the date of issue of the client receipt (which, in the normal course of events, should also be the date when the client money was received) NOT the anticipated date of banking.

(c) Receipts by telegraphic transfer and direct deposit

When money is deposited into a client bank account by telegraphic transfer, or direct deposit, the solicitor will receive notification of that fact direct from the banker (usually by telephone call, or facsimile message) or from the bank statement when reconciling the client records. If the date of the receipt is different from the date of the deposit into the client bank account, the receipt should also be recorded in the receipt thereof, the date of the deposit into the client bank account.

To enable these funds to be recorded through the client records, a client receipt must be issued. Before issuing the receipt, written confirmation should be obtained from the bank in relation to the telegraphic transfer, or direct deposit, quoting the following information:-

- (i) the date;
- (ii) the amount;
- (iii) the name of the current account to be credited and the account number;
- (iv) the remitting party;
- (v) a statement that the effects are clear; and
- (vi) the signature of the responsible bank officer (if possible).

Such written confirmation can be by means of a facsimile message, or a bank receipt to be obtained at the next attendance at the bank.

(d) Risks of deficiency

Failure to obtain such written confirmation may result in a deficiency, or even a fraud being committed at the solicitor's expense. The dangers of issuing a receipt, without obtaining written verification, are as follows:-

- (i) **Drawing against uncleared funds** - There is no guarantee that the funds being transmitted are cleared funds. Cheques lodged for remittance by telegraphic transfer are capable of being dishonoured.
- (ii) **Proceeds credited to the wrong account** - The remitter of a telegraphic transfer states the name of the account to be credited, but may not specify that the funds are to be paid to the client account. If the funds are credited to the office account and the solicitor then draws a client account cheque against these funds, a deficiency on client account will result.
- (iii) **Advice of incorrect amount lodged** - A transposition error may occur, such as recording the figure of \$8,300.00, instead of \$3,800.00. If a cheque for \$8,300.00 is drawn on the client account, a deficiency will result.

(e) Informative recording

The duplicate client receipt is the voucher from which entries are posted to the client account cash book and it is in the solicitor's interests for the information on client receipts to be fully informative. When funds are received to cover several different proposed payments it is advisable to record each amount received, rather than to record the total amount as being received under a collective heading such as "costs and outlays".

(f) Cancelled client receipt

If a client receipt is cancelled, both the original and duplicate receipts must be retained in the receipt book and both forms should be marked "cancelled".

(g) Paragraph 3, Appendix 5, Practice Directions 1990 - Receipt of client money and trust money

- "(i) The firm should have procedures for identifying client money and trust money, including cash, when received in the firm, and for promptly recording the receipt of the money either in the books of account or a register for later posting to the client cash book and ledger accounts. The procedures should cover money received through the post, electronically or direct by fee earners or other personnel. They should also cover the safekeeping of money prior to payment to bank.*
- (ii) The firm should have a system which ensures that client money and trust money is paid promptly into client account.*
- (iii) The firm should have a system for identifying money which should not be in a client account and for transferring it without delay.*
- (iv) The firm should determine a policy and operate a system for dealing with money which is a mixture of office money and client money (or trust money), in compliance with rule 5 of the Solicitors' Accounts Rules."*

1.4.4 DEPOSIT IN CLIENT ACCOUNT

(a) Deposit without delay

"Client account" means a current or deposit account at a bank in the name of the solicitor in the title of which the word "client" appears." [Rule 2, Solicitors' Accounts Rules]

"Subject to the provisions of rule 9 of the Solicitors' Accounts Rules, a solicitor who holds or receives client's money, or money which under rule 4 he is permitted and elects to pay into a client account, shall without delay pay such money into a client account." [Rule 3(1), Solicitors' Accounts Rules]

"For the purposes of rule 3 of the Solicitors' Accounts Rules, a solicitor shall keep not less than one client account and may keep as many such accounts as he thinks fit." [Rule 3(2), Solicitors' Accounts Rules]

Therefore client's money received by a solicitor should be banked in the client bank account on the day of receipt or, when that is not reasonably practicable, on the next business day.

(b) Pitfalls

Common pitfalls in relation to deposit of client's money into client account include:-

- (i) banking client's money without issuing a client receipt;
- (ii) failing to bank client's money for which a client receipt has been issued;
- (iii) late banking of receipted client's money.

(c) Proper procedures

Irregularities will be overcome if the correct procedures are adopted.

- (i) The banking of receipted client's money should be done at a regular time each day.
- (ii) The amounts of the duplicate client receipts since the last banking should be totalled, and this total should agree with the total of the banking as recorded on the bank pay-in-slip. If the two totals do not agree, the matter should be investigated promptly. Client receipts will have to be issued for any money included in the banking if a client receipt has not already been issued. If money has been receipted but not included in the banking, those moneys will have to be located and banked.
- (iii) The back of the last duplicate client receipt for money included in the banking should record the date of the banking and the amount of the banking.

When a solicitor must make prompt payment from funds received and the funds were received other than by way of cash or telegraphic transfer of cleared funds, the solicitor will need to ensure the cheque is honoured before payments can be made from the client bank account.

It is advisable to maintain a cheque clearance register. Sample entry is set out as follows:-

Cheque Clearance Register						
Date	Client	Cheque Drawer	Bank & Branch	Amount	Date Advised & Officer	Answer
19/2/XX	Peter & John Co.	Mr. Peter Ma	HK Bank Causeway Bay	HK\$50,000	21/2/XX Amy Li	Paid

1.4.5 CLIENT CHEQUES AND CHEQUE REQUISITIONS

(a) Nomination of authorised persons

The firm should establish clear procedures for ensuring that all withdrawals from client accounts are properly authorised. In particular, suitable persons, consistent with rule 7A of the Solicitors' Account Rules, should be named for the following purposes:

- (i) authorisation of internal payment vouchers;
- (ii) signing client account cheques;
- (iii) authorising telegraphic or electronic transfers.

(b) Points to note for authorised persons

The person nominated for the purpose of authorising internal payment vouchers should, for each payment, ensure that there is supporting evidence showing clearly the reason for the payment, and the date of it. Similarly, persons signing cheques and authorising transfers should ensure that there is a suitable voucher or other supporting evidence to support the payment.

(c) Risk assessment on uncleared funds

The firm should have a system for checking the balances on client ledger accounts to ensure no debit balances occur. Where payments are to be made other than out of cleared funds, clear policies and procedures must be in place to ensure that adequate risk assessment is applied.

NB If incoming payments are ultimately dishonored, a debit balance will arise, and full replacement of the shortfall will be required under rule 9A(1) of the Solicitors' Accounts Rule.

(d) Transfer of costs from client account to office account

"The firm should establish systems for the transfer of costs from client account to office account in accordance with rule 9(2)(c) of the Solicitors' Accounts Rules. Normally transfers should be made only on the basis of rendering a bill or written intimation. The payment from the client account should be by way of cheque or transfer in favour of the firm or sole principal." [Paragraph 4(4), Appendix 5, Practice Directions 1990]

(e) Unused client account cheques

"The firm should ensure that unused client account cheques are stored securely to prevent unauthorised access. Blank cheques should not be pre-signed. Any cancelled cheques should be retained." [Paragraph 5(7), Appendix 5, Practice Directions 1990]

(f) Relevant rules - Solicitors' Account Rules governing the payment from client account

(i) Drawings from a client account - Rule 7

"There may be drawn from a client account-

(a) in the case of client's money

(i) money properly required for a payment to or on behalf of the client;

(ii) money properly required for or towards payment of a debt due to the solicitor from the client or in reimbursement of money expended by the solicitor on behalf of the client;

(iii) money drawn on the client's authority; and

(iv) money properly required for or towards payment of the solicitor's costs where a bill of costs or other written intimation of the amount of the costs incurred has been delivered to the client and the client has been notified that money held for him will be applied towards or in satisfaction of such costs;

(b) in the case of trust money, including money held by the solicitor as solicitor-trustee-

(i) money properly required for a payment in the execution of the particular trust; and

(ii) money to be transferred to a separate bank account kept solely for the money of the particular trust;

(c) such money, not being money to which either paragraph (a) or (b) applies, as may have been paid into the account under rule 4(b) or (d); and

(d) money which may by mistake or accident have been paid into the account in contravention of rule 6:

Provided that in any case under paragraph (a) or (b) the money so drawn shall not exceed the total of the money held for the time being in such account on account of such client or trust."

(ii) Authority required for drawing money from client account - Rule 7A

- "(1) No money shall be drawn from a client account under rule 7 unless one of the following persons has specifically authorized in writing its withdrawal, namely -*
- (a) the solicitor in whose name the client account is kept or, where the client account is kept in the name of a firm, any solicitor, partner, consultant or foreign lawyer in the firm;*
 - (b) a certified public accountant as defined in the Professional Accountants Ordinance (Cap. 50); or*
 - (c) a person approved by the Council, which approval shall only be given in exceptional circumstances, upon an application in writing made to it by the solicitor or firm and subject to such conditions as the Council may think fit, if any.*
- (2) Paragraph (1) shall not apply to the transfer of money from one client account to another client account at the same bank."*

(iii) Further restrictions on drawings from client account - Rule 8

- "(1) No money drawn from a client account under rule 7(a)(ii) or (iv), (c) or (d) shall be drawn except by-*
- (a) a cheque drawn in favour of the solicitor; or*
 - (b) a transfer to a bank account in the name of the solicitor not being a client account.*
- (2) No money other than money permitted by rule 7 to be drawn from a client account shall be so drawn unless the Council, upon an application in writing made to it by the solicitor, specifically authorizes in writing its withdrawal."*

(g) Cheque requisition particulars

All the following information must be shown on a cheque requisition:-

- (i) date of payment;
- (ii) name of the payee;
- (iii) what the payment represents;
- (iv) the transaction in respect of which the payment was made;
- (v) the amount.

Set out below is a sample of a cheque requisition:-

CLIENT CHEQUE REQUISITION		FILE NO./MATTER NO.: _____																																				
FILE NAME: _____		LAWYER/STAFF: _____		DATE: _____																																		
MATTER: _____																																						
PAYEE	SORT CODE	BANK CODE	AMOUNT	CHEQUE NO.	FOLIO																																	
<table style="width: 100%; border: none;"> <tr> <td style="width: 33%;">1. Courier</td> <td style="width: 33%;">12. Counsel Fee</td> <td style="width: 33%;">22. _____ Instalment</td> </tr> <tr> <td>2. Fax</td> <td>13. Further Deposit</td> <td>23. Certified Copying Charges</td> </tr> <tr> <td>3. Photocopying</td> <td>14. Part Payment/Balance of Purchase Price</td> <td>24. Land Searches Fees</td> </tr> <tr> <td>4. Search Fee (others)</td> <td>15. Stakeholder Money</td> <td>25. Company Searches Fees</td> </tr> <tr> <td>5. Travel Expenses</td> <td>16. Apportionment Account</td> <td>26. B.R. Fee</td> </tr> <tr> <td>6. Miscellaneous</td> <td>17. Deposit to Court/O.R./Others</td> <td>27. Annual License Fee</td> </tr> <tr> <td>7. Stamp Duty</td> <td>18. Rental Deposit</td> <td>28. Enquiry Fee</td> </tr> <tr> <td>8. Registration Fee</td> <td>19. Principal & Interest/Redemption Money</td> <td>29. Bank Charges</td> </tr> <tr> <td>9. Court Filing Fee</td> <td>20. Rent for _____ to _____</td> <td>30. Trade Mark Fees</td> </tr> <tr> <td>10. Company Filing Fee</td> <td>21. Paid Bill No. _____</td> <td> </td> </tr> <tr> <td>11. Telephone</td> <td> </td> <td> </td> </tr> </table>						1. Courier	12. Counsel Fee	22. _____ Instalment	2. Fax	13. Further Deposit	23. Certified Copying Charges	3. Photocopying	14. Part Payment/Balance of Purchase Price	24. Land Searches Fees	4. Search Fee (others)	15. Stakeholder Money	25. Company Searches Fees	5. Travel Expenses	16. Apportionment Account	26. B.R. Fee	6. Miscellaneous	17. Deposit to Court/O.R./Others	27. Annual License Fee	7. Stamp Duty	18. Rental Deposit	28. Enquiry Fee	8. Registration Fee	19. Principal & Interest/Redemption Money	29. Bank Charges	9. Court Filing Fee	20. Rent for _____ to _____	30. Trade Mark Fees	10. Company Filing Fee	21. Paid Bill No. _____		11. Telephone		
1. Courier	12. Counsel Fee	22. _____ Instalment																																				
2. Fax	13. Further Deposit	23. Certified Copying Charges																																				
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6. Miscellaneous	17. Deposit to Court/O.R./Others	27. Annual License Fee																																				
7. Stamp Duty	18. Rental Deposit	28. Enquiry Fee																																				
8. Registration Fee	19. Principal & Interest/Redemption Money	29. Bank Charges																																				
9. Court Filing Fee	20. Rent for _____ to _____	30. Trade Mark Fees																																				
10. Company Filing Fee	21. Paid Bill No. _____																																					
11. Telephone																																						
Client Funds Balance after payment: _____																																						
AUTHORIZED BY: _____		PROCESSED: _____		DATE: _____																																		

It is not necessary to draw a separate client account cheque for each payment. If a number of payments are to be made to the one payee for a number of transactions (e.g. payments to a search company, or the solicitor's office account), it is only necessary to draw one client account cheque. However, full details of each transaction must be recorded on the cheque requisition.

Cheques which have been spoilt or are considered unsuitable for issue should be marked "cancelled" and stapled to the cheque stub.

Client account cheques must never be issued on behalf of a client until banked cleared funds are held on behalf of the client at the branch of the bank where the client bank account is maintained. Cleared funds lodged at another branch of remittance to a solicitor's client bank account cannot be drawn against until the deposit has actually been processed by the branch of the bank where the solicitor maintains his or her client bank account.

Under no circumstances should a solicitor draw a client account cheque against unbanked cleared funds in the solicitor's possession. Those cleared funds could be stolen, lost or destroyed before being banked. In these circumstances the presentation and payment of the solicitor's client account cheque would result in a deficiency of client money.

(h) Online banking

Solicitors are being encouraged by banks to adopt online banking facilities. There is nothing to prevent solicitors using such systems provided that necessary precautions are taken.

Before adopting online banking facilities the liability clauses must be clearly understood. A transaction is authorised by a password. The control of password security by a solicitor is essential and is the basis upon which the system is built. If the bank receives a valid transaction authority with the correct passwords entered, then the transaction will be processed without question. The person who enters the transaction may never be identified if there is a lack of control over the use of security passwords.

Also audit trails must be reviewed to ensure that transaction references in the cash book and bank statement enable a transaction to be traced through the records. Original bank statements must be retained and the same controls must be implemented for electronic fund transfers as those adopted when signing client cheques. Before online banking is used within a legal practice, the policy must be properly documented, fully understood by all partners and staff and the processes regularly reviewed.

1.4.6 CLIENT CASH BOOK

(a) Types of client cash book

A solicitor can either record details of receipts and payments in one book (the client account cash book) or maintain two separate client cash books (client account cash receipt book and client account cash payment book). If only one book is maintained, receipts may be recorded on one side of the book and payments on the other, or receipts may be recorded in the first half of the book and payments in the second half.

The client cash books are the only books of original entry for client accounting. Full particulars of moneys received and paid must be recorded in these cash books within three(3) working days of the receipt or payment [Rule 10(2), Solicitors' Accounts Rules]. Details of receipts and payments are posted to the client ledger from the client cash books and full particulars of client money received and paid must therefore be recorded in the client cash books.

(b) Client cash receipt book

The entries in the client cash receipt book are posted from the duplicate client receipts. All information recorded on the duplicate client receipts should be recorded in the client cash receipt book.

Set out below is a sample of a client cash book – receipt

Date	File no.	Particulars		Receipt No.	Amount Received	Total of banking
01/01/XX	1210	Received from Mr. Black Costs on account Re: Mr. Black's probate	50,000	100	HK\$ 50,000	HK\$
01/01/XX	1109	Received from FGH company Balance of purchase price Registration fee Search fee Re: purchase of House C	1,000,000 2,500 270 1,002,770	101	1,002,770	1,052,770
03/01/XX	1219	Received from Ms. Pink Counsel's fee Re: litigation (H.C. no.25)	30,000	102	30,000	30,000
30/01/XX	1212	Received from CY Ho Settle bill no. 235 Court filing fee	4,500 750 5,250	103	5,250	5,250
31/01/XX		Balance carried forward			1,088,020	1,088,020

The purpose of each column is as follows:-

Date – the date that client funds are received is the date to be recorded in the date column and not the date on which the entry was actually posted;

File number – the file number that relates to the client's money received;

Particulars – the information in the particulars column should always indicate:-

- (i) from whom the money was received;
- (ii) for what purpose the money was received;
- (iii) a brief description of the matter for which the money was received.

Receipt Number – as the client's money received should be recorded in the client receipt book immediately, the receipt numbers as recorded in this column should be in strict numerical order;

Amount Received – the actual amount received is recorded;

Total of Banking – the amount banked to the client bank account is recorded against the latest client account receipt number included in the deposit.

(c) Client cash payment book

The entries in the client cash payment book are posted from the client cheque requisitions. All information recorded on the client cheque requisition should be recorded in the client cash payment book, as the details recorded in the client ledger are posted from the client cash payment book.

Set out below is a sample of a client cash book - payment

Date	File no.	Particulars		Cheque No.	Amount paid	Cheque amount
02/01/XX	1158	Mr. Big & Co. Counsel's fee	3,000	4901	HK\$ 3,000	HK\$ 3,000
		Re: Consultation on Basic law				
15/01/XX	1205	HKSAR B.R.fee	2,250	4902	2,250	2,250
		Re: Incorporation of Joy Limited				
26/01/XX	1168	Mr. Yellow Refund of client money	1,500	4903	1,500	1,500
		Re: Immigration to Canada				
30/01/XX	1268	Mr. White Stakeholder Money	1,500,000			
		Interest on stakeholder money	5,546			
			1,505,546	4904	1,505,546	1,505,546
		Re: Sale of Flat C, Seaview Building				
31/01/XX		Balance carried forward			1,512,296	1,512,296

The purpose of each column is as follows:-

Date – the date on which the client cheque is drawn is the date to be recorded in this column and not the date when the entry was actually recorded in the client cash payment book;

File number – the file number that relates to the payment of client's money;

Particulars – the information in the particulars column should always indicate:-

- (i) to whom the payment was made;
- (ii) what the payment represents;
- (iii) a brief description of the matter for which the payment was made.

Cheque number – the client cheque numbers are recorded in the cheque number column. These particulars should be in numerical order;

Amount paid – the amount to be debited to each client's individual client ledger account is the amount recorded in this column. Usually this is the same amount as the amount of the client cheque. However, when one client cheque is issued for payments for more than one transaction (e.g. refund of stakeholder money and interest), the individual amount applicable to each transaction is recorded in the paid amount column against each client account;

Cheque amount – the amount of each client cheque is recorded in this column.

(d) General

The entries in the client cash book(s) must be posted to the client ledger within three (3) working days of the receipt or payment. Ideally, the person responsible for the completion of the client accounts records should attend to posting all the previous day's receipts and payments as the first office duty each morning.

When each page of the client account cash book is completed during the month, the totals of the last two columns are to be added and carried forward to a new page.

At the end page of each month, the client cash book is to be balanced.

The money columns in both the client cash receipt book and the client cash payment book are to be totalled. In the cash payment book, the two money columns should always agree.

The first money column in the cash receipt book represents the total of client money received by the solicitor during the month. The second money column in the cash receipt book represents the total of client money banked and could vary from the total of client money received. The difference would be attributable to either:-

- (i) client funds received in the previous months and included in the initial bank deposit in the month being balanced; or
- (ii) client funds received on the last business day of the month but not banked until the first business day of the next month;

The client cash book balance at the end of each month is arrived at by performing the following calculation, details of which should be recorded in the client account cash book as a permanent record:

Date	Particulars	HK\$
31/12/XX	Balance as at 31/12/XX	1,388,356
	Plus : Receipts for Jan XX	<u>1,088,020</u>
		2,476,376
31/01/XX	Less: Payment for Jan XX	<u>1,512,296</u>
	CASH BOOK BALANCE 31/01/XX	<u>964,080</u>

(e) Dishonoured cheques

The dishonour of a cheque occurs when a cheque has been received, a receipt issued and the cheque banked, and the bank has subsequently advised that the cheque has not been met on presentation. This type of transaction is not a cancelled receipt. The method to be adopted for recording this type of transaction is:

- (i) Retain the notification of dishonour from the bank in the appropriate file;
- (ii) Enter the reversal in the cash book by rewriting the entry in the cash receipts book, adding the reason for reversal and entering the amount as a negative amount. This has the effect of cancelling the original entry;
- (iii) Posting the entry to the debit side of the ledger. (The opposite side to the original receipt);
- (iv) If the receipt, which is subject to the dishonour notice, has been drawn against, then the funds must be made good by deposit of that sum from the office account to the client account. A receipt is issued for this transaction and entered in the receipts cash book, and credited to the client ledger that is the subject of the dishonour.

(f) Cancelled cheques

There will be occasions when after having made out a cheque but before issuing the cheque to the client, an error is discovered. As long as the original cheque is in the possession of the firm then it is permitted to cancel the cheque. The procedures should be as follows:-

- (i) The cheque is to be crossed "Cancelled" and the signature torn from the cheque.
- (ii) The cheque requisition is to be crossed "Cancelled" and the reason for cancellation recorded.
- (iii) The cancelled cheque is to be retained and stapled to the cheque requisition.
- (iv) The cheque requisition is to be retained and filed to the corresponding file for reference.
- (v) The entry is to be recorded in cheque number sequence in the cash book with the notation reading "Cancelled", the reason for cancellation and a "Nil" dollar value recorded.
- (vi) The entry is not posted to a ledger account under the manual accounting system.

(g) Reversal of a cheque

Principle 13.03 of the Hong Kong Solicitors' Guide to Professional Conduct Volume 1 (2nd edition) provides that a client account cheque must not be stopped except for good reason and with prompt and effective notice to the payee or his agent.

There will however be occasions when a cheque has been made out and issued to the client and an error is subsequently discovered requiring payment of the cheque to be stopped. Example of this type of transaction would be a cheque issued for an incorrect amount. The procedures to be followed when reversing a cheque are:

- (i) Contact the person or firm to whom the cheque has been issued and advise of the problem.
- (ii) Contact the bank and request the issue of a stop payment order.
- (iii) Enter the reversal in the cash book by rewriting the entry in the cash book, adding the reason for reversal and entering the amount as a negative amount. This has the effect of cancelling the original entry.
- (iv) Post the entry to the credit side of the ledger (the opposite side to the original cheque).
- (v) If applicable, issue a replacement cheque in the normal manner.

1.4.7 CLIENT JOURNAL

(a) What is a client journal

The client journal is used by the accounting system to record all "non-cash" transactions, that is transactions that do not involve the receipt of cash/cheques or the payment of cash from the client account.

The client journal is one of two books of entry to the client ledger. Full particulars of money transferred from one client ledger account to another must be recorded in it and posted to the client ledger.

For a manual accounting system, client account journal entries should be recorded in a bound book.

For a computerised client accounting system, a client accounts journal requisition form should be created for each journal entry.

(b) Making a journal entry

The information that has to be recorded in a client journal includes:-

- (i) the date of the journal entry;
- (ii) the name of the client ledger account from which the money is transferred;
- (iii) the name of the client ledger account to which the money is transferred;
- (iv) the amount transferred;
- (v) the reason for the transfer;

(vi) the authorisation of the transfer.

Set out below is a sample of a client journal:-

Date	Journal no.	File no.	Particulars	Dr.	Cr.	Authorisation
23/01/XX	1000	1276 1294	Mr. White : translation of M & A. Mr. White : drafting S&P agreement Re: transfer costs on account for the same client	HK\$ 1,500	HK\$ 1,500	
28/01/XX	1001	1198 1230	So & So Co. Wai On Co. Re: Loans between clients	5000,000	500,000	

The information to be recorded in the journal is as follows:

Date Column – The date of the journal entry is recorded in this column.

Journal No. – The number of the journal entry is recorded in this column. The entries in the client account journal must be posted to the client ledger. This should be done immediately after posting receipts and payments.

File Number – Record the file to be transferred to/from in the journal entry.

Particulars Column – The names of the relevant client ledger accounts are recorded in this column.

Debit & Credit Columns – The amount transferred should be recorded in each of these columns. The debit column is used for the account from which the money is being transferred. The credit column is used for the account to which the money is being transferred.

Authorisation Column – Each journal entry is to be authorised by the client or an authorised signatory to the client account. The authorisation is to be evidenced by the client, or authorised signatory, signing the journal entry in the authorisation column. Journal entry should also not be completed unless the transfer has been authorised by the person on whose behalf the money is held. It is considered good internal control that the transfer is approved by the handling solicitor.

It is not essential that there be an authorisation column. The signature of the client, or authorised signatory, can be recorded in any of the columns but should be recorded on the last line of the journal entry.

"The firm should establish policies and operate systems to control and record accurately any transfers between clients of the firm. Where these arise as a result of loans between clients, the written authority of both the lender and borrower should be obtained." [Paragraph 4(5), Appendix 5, Practice Directions 1990]

1.4.8 CLIENT LEDGER

(a) What is a client ledger

Client ledger is the accounting document that draws together all transaction types i.e. receipts, payments and journals relating to one matter in order to provide the history relative to that matter and the matter balance.

Details of all client funds held by a solicitor on behalf of clients must be correctly recorded in client's individual client ledger accounts so that the actual position, on any given day, can be ascertained.

The client ledger comprises of clients' individual client ledger accounts with credit balances.

Details of client receipts and payments must be posted to the client ledger within three (3) working days after the date of the receipt or payment. This should be done immediately after the details of such receipts and payments have been recorded in the client cash receipt book and client cash payment book.

A separate client ledger account should be opened for each matter for the same client.

Generally speaking, a separate client ledger account should be maintained for each separate party to a transaction. For instance, in a conveyancing transaction where a solicitor acts for both parties the balance of purchase money received from the purchaser prior to settlement are to be credited to a client ledger account in the name of the purchaser. Further, the settlement moneys retained after settlement for future accounting on behalf of the vendor (e.g. funds retained to pay the vendor's professional costs) are to be held in a client ledger account in the name of the vendor.

For a manual accounting system, loose-leaf sheets should be used and kept in a binder.

Set out below is a sample of a client ledger:-

Client: FGH Company
 343 Queens Road, Central

Matter: Purchase of House C

File no. 1109

Date	Particulars		Folio	Dr.	Cr.	Balance
				HK\$	HK\$	HK\$
01/01/XX	Balance of purchase price	1,000,000				
	Registration fee	2,500				
	Search fee	270				
		1,002,770	101		1,002,770	1,002,770
02/02/XX	HKSAR Registration fee		4905	2,500		1,002,770

Client name and matter – The full name, address and file number of the client should be recorded in the heading of the client ledger account together with full details of the matter.

Date – The date of the transaction according to the details recorded in the client cash receipt book or the client cash payment book should be recorded in this column.

Particulars – All information recorded in the client cash book should be recorded in the client ledger. The solicitor can take as many lines as are necessary to record the required information. The recording of such detailed information in the client ledger will benefit the solicitor, in that it will greatly reduce the need to refer to the transaction files, thus saving considerable time.

Folio – The relevant receipt numbers, cheque numbers or journal numbers are recorded in this column.

Debit – The amount of each payment is recorded in this column.

Credit – The amount of each receipt is recorded in this column.

Balance – The amount of funds held on behalf of the client is recorded in this column. This must be calculated after each transaction. Individual client ledger accounts must never have a debit balance. However, if this does occur, the letters “DR” should be recorded in the balance column.

Immediately a client ledger account records a debit balance, the solicitor must deposit funds to the client account for that individual client ledger account in order to restore that client ledger account to a nil, or credit balance.

(b) Referring to the client ledger before drawing a client cheque

Before drawing a client cheque a solicitor must be satisfied that there are banked cleared funds available in the relevant client ledger.

The solicitor must also be satisfied that the client funds held in the client's ledger account are available for the purpose required. Funds received for a specific purpose constitute a specific trust and cannot be used for any other purpose. Therefore, the mere fact that funds are available in the client's ledger does not mean that the solicitor is able to draw a client cheque.

Accordingly, it is important that the posting of the client ledger be up-to-date and that details of receipts and payments clearly record the purpose for which the client money were received or paid. The more information recorded in the client ledger, the better.

1.4.9 CLIENT ACCOUNT RECONCILIATION

(a) Relevant rule

- (1) According to rule 10A, Solicitors' Accounts Rules, a solicitor who holds or receives clients' money or pays money into a client account must:

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- "(a) at least once a calendar month compare the balance shown on clients' cash book with the total of –
- (i) the balances shown on the statements and passbooks (after allowing for all unrepresented items) of all client accounts and of any account which is not a client account but in which the solicitor holds client's money under rule 9(2)(a); and
 - (ii) any client's money or trust money held by the solicitor in cash; and
- (b) as at the same date when he makes a comparison pursuant to paragraph (a) –
- (i) prepare a listing of all the balances shown by the clients' ledgers of the liabilities to clients (and other persons, and trusts), and compare the total of those balances with the balance shown on the clients' cash book; and
 - (ii) prepare a reconciliation statement, which must show the cause of the difference, if any, shown by each of the comparisons referred to in subparagraph (i) and paragraph (a)."

(2) Paragraph 5(4) of Appendix 5, Practice Directions 1990 provides that *"the firm should operate a system to ensure that accurate reconciliations of the client accounts, whether comprising client and/or trust money, are carried out once a calendar month. In particular it should ensure that:*

 - (a) *a full list of client ledger balances is produced. Any debit balances should be listed, fully investigated and rectified immediately. The total of any debit balances cannot be "netted off" against the total credit balances;*
 - (b) *a full list of unrepresented cheques is produced;*
 - (c) *a list of outstanding lodgments is produced;*
 - (d) *formal statements are produced reconciling the client account cash book balances, aggregate client ledger balances and the client bank accounts. All unresolved differences must be investigated and, where appropriate, corrective action taken;*
 - (e) *a partner checks the reconciliation statement and any corrective action, and ensures that enquiries are made into any unusual or apparently unsatisfactory items or still unresolved matters."*

The way to balance the client cash book is explained in 1.4.6 (d)

The listings of client ledger balances must all have credit balances and be kept as a permanent record for verification by the auditor.

Set out below is a sample of a client account reconciliation:-

Client Bank: Account no.: For the month ended: 31/01/XX					
				HK\$	HK\$
					956,238
Balance as per bank statement					
Less: unrepresented cheques					
Cheque no.	issued date	present date		1,257	
4955	29/01/XX	01/02/XX		2,346	
4956	31/01/XX	03/02/XX		1,555	
4958	31/01/XX	03/02/XX			5,158
Add: Outstanding deposits:					
Deposit date					
31/01/XX				10,500	
31/01/XX				2,500	
					13,000
Balance as per client cash book					964,080
Less: Balance as per listing of client balances-schedule 1					964,080
					0

Listing of client ledger balances		schedule 1	
as at 31/10/XX			
		Dr	Cr.
File no.	Client name		
1000	Noble Company		1,246
1010	Mr. Bee		5,762
1011	Koe Limited		46,813
1020	Ms. Wong		156,543
1249	Chak Cheung Manufacturing Limited		50,568
1250	Paper & Clips Co		482,453
1251	Mr. Cheung and Ms. Lee		61,000
1252	E & D Limited		158,695
			963,080
Add: Initial bank deposit			1,000
		0	964,080

Note: Any debit balances should be fully investigated and rectified immediately.

(b) General:

- (i) The client bank statement balance must be reconciled with the client cash book balance to verify that the total amount of funds recorded by the solicitor in the client cash book is correct.
- (ii) The client bank statement balance is reconciled to the client cash book by checking the details recorded on the client bank statement against the entries in the client cash book.
- (iii) Each cheque recorded in the client bank statement should be ticked, with a tick also being recorded against the cheque in the client cash book. This exercise is to ascertain details of cheques drawn but not presented. Therefore, the entries are checked from the client bank statement to the client cash book and not from the client cash book to the client bank statement.
- (iv) A solicitor should, on opening a client account, give a written authority to the bank to debit all bank charges to the solicitor's office bank account. However, if bank charges are sometimes debited to the client bank account, the solicitor must verify and correct the entries.
- (v) Cheques drawn in previous months and presented for payment during the current month are ticked in the previous month's client bank reconciliation statement, not the actual entry in the client cash book.

This same procedure applies for the deposits on the client bank statement; the corresponding entries are ticked in the client cash book or, if more than one month old, on the previous month's client bank reconciliation statement.

- (vi) All drawn client cheques which have not been recorded as "paid" on the client bank statement and all receipted client funds which have not been banked are classed as unpresented items and adjustments for them are made to the client bank statement balance.
- (vii) The client bank reconciliation statement should be reviewed by the solicitor to ensure that:
 - the outstanding deposits are banked on the first working day of the next month;
 - the items in the client bank statement requiring adjustment by the bank, such as bank charges and bank interest, are reversed by the bank;
 - other items shown in the client bank statement that have not been recorded in the cash book are recorded in the cash book on the first working day of the next month e.g. telegraphic transfers;

- unrepresented cheques that are older than 6 months should be properly investigated and followed-up and the decision to reverse such unrepresented cheques in the ledger account should be based on the results of the investigation; and
- any other items shown on the previous month's client bank reconciliation have been cleared.

(c) Bank errors

Bank errors such as incorrect deposits should not be recorded in the client cash book and posted to a ledger account. They should be shown as an adjusting item in the client bank reconciliation statement and the bank should be requested to reverse them directly from the client bank statement. The items should be reviewed to ensure they are reversed.

(d) Unidentified deposits

There may be occasions when deposits are made to the client account and the source of the funds cannot be ascertained.

If at the expiration of the month following receipt, identification of the matter is not possible, and all avenues of enquiry have been exhausted, the items should be recorded in the client cash book and posted to a suspense client ledger account.

Suspense client ledger account may be used only when the solicitor can justify their use; for instance, for temporary use on receipt of an unidentified payment, if time is needed to establish the nature of the payment or the identity of the client.

(e) Non-receipted direct deposits and/or telegraphic transfers

When verifying the deposits into the client account, a solicitor may discover some deposits covering direct deposits and/or telegraphic transfers of which the solicitor has not previously received notice from the bank. Therefore, the receipt of these funds would not already be recorded in the client records.

In these circumstances, the solicitor should issue a client receipt as at the date of discovery to record the entry and should record in the body of the receipt the date of lodgment of those funds to the client bank account. The information on the duplicate client receipt should then be posted to the client cash receipt book and the individual client ledger account, with the date of the entry being recorded as the date of the receipt and not the date of banking.

It would also be necessary to make an adjustment to the client bank reconciliation statement.

The adjustment would be recorded as follows:-

	HK\$
Client bank statement balance	969,080
Less: Direct deposit by Mr. B on 29/01/XX, receipted 05/02/XX	<u>5,000</u>

Balance as per Client Cash Book 31/01/XX	964,080
--	---------

(f) Outstanding Deposits

All client money received by a solicitor must be banked in a client bank without delay save for certain exceptions under rule 9(2) of the Solicitors' Accounts Rules. Any amount recorded in the client bank reconciliation statement under the heading of outstanding deposits must refer to client money received on the last business day of the month. These funds should then be banked on the first business day of the next month. In any other circumstances, the amount receipted and not yet banked represents a deficiency of trust funds and should be recorded in the client bank reconciliation statement as a deficiency. It should not be included in the client bank reconciliation statement as an outstanding deposit.

When there is a deficiency of trust fund recorded in the client bank reconciliation statement, the solicitor is in breach of Rule 3(1) of the Solicitors' Accounts Rules as the rule requires a solicitor who holds or receives client's money, or money which under rule 4 he is permitted and elects to pay into a client account, pay such money into a client account without delay.

The adjustment would be recorded as follow:-

	HK\$
Client bank statement balance	969,080
Add: Outstanding Deposits	
- Deposit receipted on 31/01/XX, banked on 01/02/XX	6,000
	975,080
Add: Deficiency of trust fund	
- Deposit receipted on 24/01/XX, banked on 01/02/XX	4,000
Balance as per Client Cash Book 31/01/XX	979,080

(g) Unpresented client account cheques

A solicitor must account for the available client funds to the rightful beneficiaries as soon as possible. The issue of a client cheque does not discharge this obligation and the solicitor must check the client bank reconciliation statement to ascertain which cheques have not been presented. The solicitor should personally examine these outstanding items to determine whether or not he/she considers them commercially current. Generally speaking, no client account cheque should be allowed to remain outstanding for more than two months without investigation and communication with the payee. Where necessary, payment should be stopped on the unpresented cheque and a new client cheque issued in its place after confirmation by the bank of receipt of the stop payment notice.

The client bank reconciliation statement must record the date of issue, in addition to the cheque number and the amount of the unpresented cheque.

(h) Control of client account reconciliations

The firm should operate a system to ensure that accurate reconciliations of the client accounts, whether comprising client and/or trust money, are carried out once a calendar month. In particular it should ensure that:

- (i) a full list of client ledger balances is produced. Any debit balances should be listed, fully investigated and rectified immediately. The total of any debit balances cannot be "netted off" against the total credit balances;
- (ii) a full list of unrepresented cheques is produced;
- (iii) a list of outstanding lodgments is produced;
- (iv) formal statements are produced reconciling the client account cash book balances, aggregate client ledger balances and the client bank accounts. All unresolved differences must be investigated and, where appropriate, corrective action taken; and
- (v) a partner checks the reconciliation statement and any corrective action, and ensures that enquiries are made into any unusual or apparently unsatisfactory items or still unresolved matters.

1.4.10 STATEMENTS OF ACCOUNT

Statements of account can be of substantial benefit to clients by enabling them to keep track of client money held on their behalf by their 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 accounts to them.

(a) Cost and benefit of issuing statement of account

- (i) If the statement of account is issued on a regular basis (for example, on a quarterly basis), there will be incentive for the law firm to develop a more efficient accounting system, and to conduct a regular review of matters.
- (ii) 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.
- (iii) It can reduce the incidence of deliberate or unintentional mishandling of client monies.
- (iv) The cost of providing quarterly statements may not be very much higher than the cost of providing a statement upon completion.

(b) Issue of the statement of account

Solicitors should provide the client with a statement of account where:-

- (i) The matter is to complete in more than three months' time;
- (ii) Any other time upon request by the client;
- (iii) Completion of the matter.

1.4.11 REGISTERS

(a) Types of register

The registers to be maintained by a solicitor are:

- (i) bills register;
- (ii) direct payments register;
- (iii) file register;
- (iv) other registers (e.g. photocopy register, fax register, IDD register)

(b) Bills register

According to Rule 10(4), Solicitors Accounts Rules, *"every solicitor shall keep a record of all bills of costs, distinguishing between profit costs and disbursements, and of all written intimations under rule 7(a)(iv) delivered by the solicitor to his clients, which record shall be contained in a bills delivered book or a file of copies of such bills and intimations."*

Set out below is a sample of a bills register in the form of bills delivered book:-

Bill nos.	Bill date	file nos.	Client name	Handler	Total bill amount	Cost	Disbursements	Amount settled by client money	Amount receivable from client	Settlement date

Bill numbers - the bill numbers recorded in this column should be in strict numerical order.

Bill date - when the bill was issued.

File numbers - the file upon which the bill was issued.

Client name - the name of the client in respect of whom the bill was issued.

Handler - the name of person issuing the bill.

Total bill amount - the amount of the bill including the costs and disbursements.

Costs - the amount of costs shown on bill.

Disbursements - the amount of the disbursements shown on bill.

Amount settled by client money - the amount of money transferred from client costs held on account to settle bill.

Amount receivable from client - the net amount of bill awaiting settlement.

Settlement date - when the bill or the net balance was settled.

(c) Direct payments register

Paragraph 5(2) of Appendix 5, the Practice Directions 1990 provides that "central records or central registers must be kept in respect of:

- (a) accounts held for client money, or trust money, which are not client accounts (rule 9(2)(a) of the Solicitors' Accounts Rules);*
- (b) joint accounts; and*
- (c) clients' own accounts (rule 9(2)(a) of the Solicitors' Accounts Rules)."*

Rule 9(2)(a), *Solicitors' Accounts Rules* states:

"A solicitor shall not pay into a client account client's money held or received by him which the client for his own convenience requests the solicitor to withhold from such account."

Where client's money is not paid into a client account, details of the manner in which it has been dealt with should be recorded by the solicitor in a Direct Payments Register. The Register should constitute part of the solicitor's client account records and be subject to independent scrutiny in the same manner as those records.

Set out below is a sample of a direct payments register:-

Receipts					Payments			
Date	Received from	Particulars	Form of receipt	Amount	Date	Payment made to	Form of payment	Amount

The Direct Payments Register should indicate

Receipt date - when the money was received.

Received from - the name and address of the person from whom the money was received.

Particulars - the nature of the receipt and any direction for payment made by the person for or on whose behalf the money was received.

Form of receipt - whether the money was in cash, cheque or other form; if the money received in the form of a cheque, the cheque number and the bank upon which the cheque was drawn; and the manner in which it was received (for example, in person or by post).

Receipt amount - the amount of money received.

Payment date - the date on which the payment was made.

Payment made to - the name and address of the person to whom the money was paid.

Form of payment - the form in which payment was made (for example, cash or cheque); and the manner in which the payment was delivered (for example, in person or by post).

Payment amount - the amount of money which was paid.

(d) File register

The register is designed to provide a history in relation to all matters conducted by a practice. Legal practices normally maintain such a register by cards filed either in numerical and/or alphabetical order.

Particulars relating to new instructions are recorded on new cards. The card should be allocated the next number and should be filed in numerical order. The file is opened using this reference number. This reference number is quoted on all correspondence issued by the firm. It is suggested that wherever possible the same reference number be used within the accounting system, with the appropriate general or subsidiary ledger reference added.

Set out below is a sample of a file register:-

ABC & Company File Index Card		
Client		
Name:		
Contact Person:		
Address:		
Phone:	Fax:	E-mail
File		
Number:	Date Opened:	Date Closed:
Matter:		
Referral	Responsible Partner:	Handler:

If the numerical file register is maintained, it is appropriate to maintain a client register. This register is also normally maintained by the use of cards. The advantage of this register is that all matters conducted on behalf of a client can be readily identified. The register can also be used to maintain details relating to wills and security documents held on behalf of clients. This register is filed in alphabetical order by surname.

Set out below is a sample of a client register:-

ABC & Company Client register			
Client			
Name			
Contact Person:			
Address			
Phone	Fax:	E-mail:	
Matters:			
Matter No.	Description of Matter	Date Opened:	Date Closed:

If the file register is maintained in alphabetical order, then the same information is recorded as shown on the file index card above. The card is then filed in surname order.

There are many methods of maintaining a file register. The design and details recorded in the register is basically set by the information that the practice requires to be recorded in summary on each matter or client. The basic requirement of any file register is to provide a reference point to the location of the file and other relevant records.

(e) Other registers

Maintaining registers/records of details of costs and sundry items recoverable for particular matters may assist collection of the same by the firm.

(i) Photocopy register

The objective of maintaining a photocopying register is to record all photocopies made on behalf of individual matters. These charges may subsequently be recouped from the client when the matter is billed. There are many forms of a photocopy register from the simple sheet of paper through to the more advanced computer technology known as "Disbursement Recovery Device" which requires the entry of an account number prior to commencing the photocopying.

It should be noted that all expenses related to the photocopier such as toner, paper and services are recorded in the accounting system under the photocopying expense account.

The most common method of recording the photocopies is in the form of an exercise book which is left in close proximity to the photocopier. Employees are required to record the number of copies, the matter number, matter description and the date the copies were taken. The question as to whether these charges are posted to the individual ledger in the accounting system or simply recorded and subsequently charged to the client when billed, is a matter for each practice. The simplest method is to ensure that the entries recorded in the photocopy register are transferred to an "individual matter cost recovery sheet". This will ensure that, when the bill is prepared these charges are not overlooked. A number of firms use the inside cover of the file to record photocopies and other charges to be recouped. Each method is acceptable as long as the entries in the photocopying register are transferred to the appropriate individual matter on a regular basis and charged to the client on billing.

Set out below is a sample of a photocopy register:-

ABC & Company

DISBURSEMENT - PHOTOCOPYING

Date	Client Name	file no.	No. of copies	Copy by

(ii) Fax and IDD registers

A similar register to the photocopying register should also be maintained to record the cost of transmitting faxes and telephone calls in order that the costs can be recouped, if applicable.

Set out below are samples of fax and IDD registers

ABC & Company

DISBURSEMENT - FAX

Date	Client Name	File no.	No. of copies	Signature

ABC & Company

DISBURSEMENT - IDD

Date	Client Name	File no.	Charges	Signature

2. COMPUTER CLIENT ACCOUNT SYSTEMS

With the legal profession becoming more competitive in all areas, some legal firms invest in automation technology to handle their client accounts more efficiently.

Generally speaking, for legal practices, such a computer system requires timekeeping/billing, general accounting, payroll, cheque writing, and reporting capabilities. Word processing also plays a major part in any law firm; it is equally important to address how the firm converts from their existing system to the new system. Immediate needs for word processing are converting existing documents to a new format and training on the new word processing system. Long-range plans for word processing include standardization of documents internal to the firm and long-term document storage and retrieval.

2.1 TRANSITION PERIOD (FROM OLD SYSTEM TO NEW SYSTEM)

(1) Analysis

- a. Understand the firm's problem areas;
- b. Understand the firm's long-range goals; and
- c. Identify the areas of practice that will be automated and draw up the current procedures and workflow patterns.
- d. Prepare computer software and hardware specifications and implementation plan.

Quality time spent in this phase will result in significant cost saving and a solid implementation.

(2) Identify a software vendor for configuration and recommendations

Request proposals from software vendors. The proposal should outline an implementation plan, factors such as installing cable over weekends or after office hours as well as training expectations should be included.

(3) Implementation

- a. It is recommended that automation should start with the practice area, followed by the business area (accounting).
- b. *Paragraph 2(7), Appendix 5, Practice Directions 1990 notes that "if a computer system is introduced care must be taken to ensure:*
 - i. *that balances transferred from the old books of account are reconciled with the opening balances held on the new system before day-to-day operation commences;*
 - ii. *that the new system operates correctly before the old system is abandoned. This may require a period of parallel running of the old and new systems and the satisfactory reconciliation of the two sets of records before the old system ceases."*

(4) Develop a relationship with software vendor for system maintenance

Implementing the computerised accounting system may take longer than a firm anticipated. As with most case-management systems, the initial setup requires someone to enter client and case-related information into the new system. It is recommended that the firm should review all the case files and ledger accounts, to ensure the total of client balances reconcile with the total client money at bank; and to close as many obsolete files as possible before implementation of change.

2.2 CONTROL, SECURITY AND RECORD SYSTEMS

- (1) (a) The computer system does not allow the deletion of a client ledger account unless:-
- (i) the account has a zero balance; and
 - (ii) a record of the account, as it was immediately before its deletion, is kept in a visible form;

A log should be kept for recording any deletion of client ledger account, which should be reviewed on a regular basis to detect any irregularities.

- (b) an amendment to the particulars of a transaction (including but not limited to the name and address of the client, the amount of client money, the description of the matter being conducted and the bank account number of the client account) recorded on the computer system is made by a separate transaction recorded on the system; and
- (c) a report, or each page or entry in a report generated by the computer system is numbered sequentially under the computer program control in a way that enables the completeness of the record to be conveniently audited;
- (d) a record of information produced by the computer in a visible form is produced in chronological sequence.

Manual on Solicitors' Accounting

- (e) where no hard copy of computerised records is kept, the information recorded must be capable of being reproduced reasonably quickly in printed form for at least 6 years;
 - (f) the firm has clear policies, system and procedures to control access to client accounts by determining the personnel who should have "write to" and "read only" access. Passwords should be held confidentially by designated personnel and changed regularly to maintain security. Access to the system should not necessarily be restricted to a single person nor should more people than necessary be given access.
- (2) If a solicitor keeps any books, accounts or records under a computerised accounting system, the solicitor must ensure that:-
- (a) the computer system has enough capacity and backup capability to record the client transactions; and
 - (b) the computer system is backed-up as frequently as possible and in any event, at least once a month. (It is recommended that as a matter of good practice, the system be backed up on a daily basis, if possible); and
 - (c) the back-up information is kept in a fire-proof location that is unaffected by magnetic interference or other factor that may adversely affect the stored information.
- For back-up information relating to clients' money, an off-site storage is recommended with the aim of enabling normal operations on and proper accounting for clients' money in the event of business interruption affecting the solicitor's office.
- (3) The solicitor must, as soon as practicable after the end of each month, make a printout of the following:-
- (a) a cash book containing details of receipts and payments for the month including the cash book balance at the end of the month;
 - (b) if a client ledger account is kept by a computerised accounting system - the listing of all the balances in client ledger;
 - (c) if a client account bank statement balance is reconciled with the client account cash book balance by a computerised account system - the reconciliation of the bank statement.
- (4) If a client account ledger is kept by a computerised accounting system, a solicitor must, immediately before a client ledger account is deleted from the computer system:
- (a) make a printout of the ledger account; and
 - (b) keep the printout securely in the client's file.

3. PROCEDURAL REFERENCE

3.1 INTEREST ON CLIENT BANK ACCOUNTS

The Council of the Law Society had suspended the Practice Direction J – Interest on Clients' Account in January 2004 until such time as interest rates reached the level payable in January 1997 when the Practice Direction was promulgated.

Please also see Law Society's Circular 04-4 (SG).

3.2 CLOSING OF FILES

It is advisable that solicitors should not only keep "accounting records" of client monies but also to keep such files or other records as will explain their client money transactions. Case files can assist the solicitors, inspectors and accountants in their understanding of a particular entry in the client account records.

Solicitors should close the case files when the matters have been completed and must account for the available client money to the rightful beneficiary promptly. Small balances representing overpayments by clients should be promptly accounted to clients. To close the case files properly, the following points should be noted:

- (1) Time and disbursements records
Solicitor should make sure that all time and disbursements which are chargeable to a client have been billed before closing a file. For those outstanding time and disbursements records, issue a final bill to the client or otherwise have them written off, as appropriate. All time and disbursements written off should be authorised by principals of the firm.
- (2) Outstanding bills
It is a good practice to clear all the outstanding bills from client before closing file. Adjustment should be made for bills that have proved to be non-recoverable.
- (3) Ledger accounts
Completed client ledger accounts sheets should be retained in the client ledger until the entries in the ledger have been verified by the auditor. Following verification by the auditor, these ledger sheets can be transferred to a binder. File closed numbers can be allocated to the completed ledger sheets in strict numerical order for ease of reference. A copy of the client ledger showing a zero balance should be filed to the corresponding file for easy reference.

3.3 TRANSFERRING FILES BETWEEN FIRMS

The following areas need to be addressed:

- (1) Ensure that client authorisation has been obtained to transfer current client files to the new firm.
- (2) Ensure that the authorisations to transfer client money balances to the new firm have been obtained from the persons on whose behalf the moneys are held.
- (3) Review the inactive matter balances prior to transfer.
- (4) Review the bank reconciliation and reverse any cheques that may not have been presented if appropriate.
- (5) Ensure that sufficient money is retained in the existing client bank account to cover unrepresented cheques.
- (6) Ensure that records relating to the transfer of wills and securities packets are adequate and that the person for whom the records are held is advised.

3.4 BILLS ISSUED

- (1) Particulars in a bill of costs
 - (a) Section 66 of the Legal Practitioners Ordinance provides that a solicitor shall not bring an action to recover any costs due to him until 1 month after a bill has been delivered in accordance with the requirements of the section, which include the following:
 - (i) the bill must be signed by the solicitor or a partner of the firm or be enclosed in or accompanied by a letter which is so signed and refers to the bill;
 - (ii) the bill must be delivered to the party to be charged personally or by post to his office or home address or last known place of abode.
 - (b) Principle 4.10 of the Hong Kong Solicitor Guide to Professional Conduct Volume 1 (2nd edition) provides that a bill of costs must contain sufficient information to identify the matter to which it relates and in the case of interim bills must state the period covered. Further, Commentary 2 thereof states that a bill should show disbursements separately from profit costs.
 - (c) Under Rule 10(4) of the Solicitors' Accounts Rules, a solicitor should keep a bills delivered book recording all bills of costs distinguishing profit cost from disbursements and all written intimations of the amount of costs incurred delivered by the solicitor to his clients.
- (2) Interim bills

Principle 4.08 of the Hong Kong Solicitors' Guide to Professional Conduct Volume 1 (2nd edition) provides that "If a solicitor wishes to render interim bills he must have the

agreement of his client.” Care should be taken to ensure that an agreement has been reached with the client that such interim bills can be issued. The following information (which is not exhaustive) should be reviewed to determine the contents of an appropriate retainer letter:

- Scope of the retainer and services to be provided by the firm
- Agreement on circumstances permitting termination of the retainer (See Principle 5 of the Guide)
- Best estimate of the costs of the matter in hand (See Principle 4 of the Guide)
- Money on account of costs and the right to ask for additional funds for work in progress
- Hourly rates of Principal in charge of the matter
- Hourly rates of Assistants
- Hourly rates of Support staff where appropriate
- Method of billing: whether in units of 6 mins etc, charges for phone calls etc
- Client's agreement to pay interim bills e.g. monthly
- Appropriate receipts for payments of fees and/or disbursements
- Interest charges on outstanding bills
- Charges for travelling and waiting time attending court hearings
- Information on barristers fees where appropriate

Please also see Law Society's Circular 01-302.

(3) Agreed fee

Rule 9(2)(c) sets out the exceptions to the requirement that a solicitor shall pay client's money held or received by him into client account. One of the exceptions deals with the payment of agreed fee. An “agreed fee” is one that is fixed – not a fee that can be varied upwards, nor a fee that is dependent on the transaction being completed.

Principle 4.02 of the Hong Kong Solicitors' Guide to Professional Conduct Volume 1 (2nd edition) provides that “When fees have been agreed with a client the solicitor must promptly provide the client with a written record of the agreement, signed by the solicitor stating what the fee is, and what it covers and whether it includes disbursements”.

(4) In order to reduce bills write-off and to enhance a firm's cash flow, the following points should be noted:

- (a) **Set the tone for the client /firm relationship at the initial stages.** Use an engagement letter that clearly outlines what the firm will do for the client and in turn what the client's responsibility is to the firm. The engagement letter should include billing and payment agreements. Let the client know that the firm's billing terms are “net due on receipt” and obtain the client's verbal commitment to adhere to these terms.
- (b) **Adopt rigorous timekeeping procedures.** Make sure that all billable time is recorded daily. When partners and staff try to reconstruct their time at the end of

the week or month, they will lose a few hours here and there that can add up to a substantial amount of fee income over time.

It is also important to record details of timekeepers' work so the client appreciates the work performed. Clients are more likely to question vague charges such as "reviewed file," so state which file and why it was reviewed. If bills are questioned, it delays payment.

- (c) **Work in progress (WIP) should be billed on a monthly basis wherever possible.** This helps the firm's cash flow and breaks billings into smaller increments that are easier for clients to process (and afford).

Many firms carry substantially more work in progress and accounts receivable than they should. It is not unusual for firms to have 30 percent or more of their total receivables outstanding over 120 days. Added to that is work in progress, which often exceeds 40–60 days of the firm's activity.

- (d) **Standardize the billing cycle as much as possible:**

- (i) Input time daily and issue weekly time printouts for partners to review and correct so there are fewer changes when the billing memoranda are issued after each month end.
- (ii) Establish a billing timetable with dates when billing memoranda will be distributed and the last day to submit billing memoranda for correction.
- (iii) Strive for minimal attorney involvement:
- When the responsible partner receives the billing memoranda and indicates changes, the bill should be prepared and mailed from this initial input. If partners have the opportunity to revise a bill three or four times, they will do so, instead of thoroughly revising it on the first occasion.
 - All bills should be mailed by the accounting department so they are not delayed on a partner's desk.
 - Set up a series of standard cover letters for bills to save partner time.
- (iv) Revise the invoice format to include an invoice number and an early payment due date. This reinforces the message that you need to be paid promptly and gives the clients' payables clerks all the information needed to set up the invoice for payment without making subjective decisions about when payment might be due.
- (v) Establish detailed policies and procedures for the billing personnel to use as a reference guide. Many firms train by "word of mouth," losing information each time someone new is trained.

Finally, good communication up front is key to the keeping the solicitor-client relationship strong and avoiding surprises on bills.

4. CONTROLS

4.1 COMPLIANCE WITH RULES AND PROFESSIONAL CONDUCT

The Solicitors' Accounts Rules provide:

- (1) what records are to be kept; and
- (2) when certain records are to be prepared.

Sole proprietors who write up their own records are in the most advantageous position to exercise control. However, solicitors who delegate the job to their staff should ensure that the appropriate procedures are in place.

- (1) The required records are maintained.

Solicitor should ensure that the following records are maintained as required:

- (a) client ledger;
- (b) client cash book;
- (c) all dealings of the solicitor relating to his practice as a solicitor other than client ledger and client cash book;
- (d) bills record.

- (2) The information required to be recorded is so recorded.

Rules 10(1), (2), (3) and (4), the Solicitors' Accounts Rules identify the information to be recorded. Solicitors should ensure the information is included in the records by monthly reviews, if solicitors are not writing up their own records. Solicitors should also ensure that information is entered uniformly and in this regard field headings for receipt, cash book and journals are an excellent idea as it prompts the recorder to enter information on a uniform basis, making review of the documents easier.

- (3) The reports required to be produced are produced on time.

Certain reports are required at month-end:

- (a) Cash Book/control account to be balanced
- (b) Trial balance to be completed
- (c) Reconciliation of client accounts
- (d) Listing of client ledger balances

These reports are considered to be client management reports and must be called for and reviewed monthly.

4.1.1 OTHER CONTROLS

- (1) *"In addition, there should be a master list of all general client accounts and office accounts. The master list should show the current status of each account; eg currently in operation or closed with date of closure." [Paragraph 5(3), Appendix 5, Practice Directions 1990]*
- (2) The firm should maintain control of all its bank accounts opened for the purpose of holding client money and trust money. In the case of a joint account, a suitable degree of control should be exercised.
 - (a) If a solicitor acting in a client's matter holds or receives money jointly with the client, another solicitor's practice or another third party, the solicitor must ensure that:
 - (i) he keeps readily accessible a central record or file of copies of all bills of costs, distinguishing between profit costs and disbursements and of all written intimation delivered by the solicitor in respect of that joint account;
 - (ii) he preserves for at least 6 years from the date of last entry all statements and passbooks as printed and issued by the bank or all duplicate statements and copies of passbook entries in respect of that joint account; and
 - (iii) he maintains a central register of all joint accounts or keep together centrally the statements, passbooks, duplicate statements and copies of passbook entries relating to any joint account held by the solicitor.
 - (b) If the joint account is operated only by the solicitor, the solicitor must ensure that he or she receives the statements from the bank.
 - (c) If the solicitor shares the operation of the joint account with the client, another solicitor's practice or another third party, the solicitor must:
 - (i) ensure that he or she receives the statements or duplicate statements from the bank, and retains them in accordance with the Solicitors' Accounts Rules; and
 - (ii) ensure that he or she either has possession of any passbooks, or takes copies of the passbook entries before handling any passbook to the other signatory, and retains them in accordance with the Solicitors' Accounts Rules.

- (d) If a solicitor holds money jointly with a client, interest earned on the account will be for the benefit of the client unless otherwise agreed. If money is held jointly with another solicitors' practice, the allocation of interest earned will depend on the agreement reached.

4.2 CONTROL OVER ACCOUNTING STAFF

The solicitor should ensure familiarity with the accounting system in use and ensure that the reports are reviewed on a regular basis. The solicitor should review the month-end reports and require the accounting staff to report any variances to him.

The reports requiring review are:

(1) Reconciliation of client accounts

This report compares the solicitor's internal records with the external bank records. Any variances should be identified and rectified. This enables prompt detection of irregularities.

Particular emphasis should be placed on:

- (a) agreeing the bank statement balance;
- (b) agreeing the cash book balance with the reconciled cash book balance, (the balance obtained as a result of completing the bank reconciliation statement);
- (c) ensuring that outstanding deposits are legitimate and banked promptly the next working day;
- (d) ensuring the cash content is the same as the receipt;
- (e) reviewing the age of unrepresented cheques, investigating and following up on unrepresented cheques that are older than 6 months and deciding whether to reverse such stale cheques in the ledger account on the basis of the result of the investigation;
- (f) reviewing all adjusting items and checking that they are reversed correctly in the next month or recorded in the cash book if appropriate.

(2) Listing of client ledger balances

Particular emphasis should be placed on:

- (a) review of debit balances and ascertain the reason for the balance and ensure prompt correction. Procedures should be in place to ensure that all debit balances are drawn to the practitioners attention by staff before correction.
- (b) review of accounts that have not been active for some time. It is suggested that the date of last activity is shown on the trial balance. Questions should be asked as to why the money is still held if the matter has been completed.

(3) Journal entries

Journal entries may enable a transfer of money without the solicitor's knowledge.

Journal entries should all be authorised by the solicitor before the entry is processed. The journal should be reviewed for any problem entries especially entries to the control account or journal entries used to correct debit balances.

Ensure the narrations are clear.

(4) Procedures for banking and drawing cheques

Procedures should be standardised to ensure:

- (a) banking is done regularly, promptly and intact;
- (b) delays in banking are reported to the solicitor;
- (c) ledger cards are sighted prior to signing the cheque.

(5) Stationary control

Particular emphasis should be placed on:

- (a) retention of cancelled cheques and receipts;
- (b) sequence control for issuing cheques and receipts;
- (c) control over unissued cheques and receipts.

(6) Perusal of bank statements

Regular bank statements should be arranged. A review of the bank statements should concentrate on:

- (a) "bouncing" of cheques;
- (b) delays in banking compared with the banking of "presented cheques".

(7) Exception reporting

Staff should be expressly required to bring any unusual items in the client records to the immediate attention of the solicitor.

(8) Rotation of staff

It is difficult to rotate staff in small firms. However, wherever possible, it should be encouraged especially in relation to banking and handling of money.

5. POWERS OF COUNCIL

5.1 INSPECTION OF DOCUMENTS

Rule 11 of the Solicitors' Accounts Rules and Rule 5B of the Solicitors' Practice Rules

"(1) In order to ascertain whether the provisions of these rules have been complied with, the Council, acting either-

- (a) on its own motion; or*
- (b) on a written complaint lodged with it by a third party,*

may require any solicitor to produce at such time and place as may be fixed by the Council, his books of account, bank pass books, loose-leaf bank statements, statements of account, vouchers and any other necessary documents for the inspection of any person appointed by the Council, and such person shall be directed to prepare for the information of the Council a report on the result of such inspection and any such report may be used as a basis for proceedings under the Ordinance.

- (2) Upon being required so to do a solicitor shall produce such books of account, bank pass books, loose-leaf bank statements, statements of account, vouchers and documents at the time and place fixed.*
- (3) Before instituting an inspection on a written complaint lodged with it by a third party, the Council shall require prima facie evidence that a ground of complaint exists, and may require the payment by such party to the Council of a reasonable sum to be fixed by it to cover the costs of the inspection, and the costs of the solicitor against whom the complaint is made and the Council may deal with any sum so paid in such manner as it thinks fit.*
- (4) The Council may make such order for the payment of the costs of any inspection required by the Council under this rule as it thinks fit."*

6. OTHER AREAS OF CONCERN

6.1 QUALIFICATIONS OF ACCOUNTING STAFF

Paragraph 2(2), Appendix 5, Practice Directions 1990:

"The firm must hold a copy of the current version of the Solicitors' Accounts Rules. The person who maintains the books of account must have a full knowledge of the requirements of the Rules and the accounting requirements of solicitors' firms."

6.2 OPENING OF CLIENT BANK ACCOUNTS

There is no restriction on the number of client accounts that may be opened. The purpose of opening client accounts is to keep client monies separate from office monies, therefore strict control should be incorporated for the client account opening and its withdrawal in order to safeguard the clients' position.

- (1) Solicitors should consider the banks' ratings when opening client bank accounts.
- (2) Solicitors should establish the client bank account at a bank other than that of the solicitor's or firm's operating account;
- (3) A client bank account and its bank statements and cheques must be identified with the phrase 'client account'.
- (4) No banking facilities such as overdraft facilities can be arranged for the client bank accounts.
- (5) Solicitors should implement accounting procedures for the correct handling of client bank account interest and recovery of the debit bank charges.
- (6) No cash payments may be made from client bank accounts. ATM card issued with facilities to withdraw cash should have such function disabled. Should clients request to cash client cheques, appropriate risk management measures should be introduced and any cheque encashment charges should be recovered from the clients.

6.3 UNCLAIMED MONEY IN CLIENT ACCOUNTS

The Solicitors' Accounts Rules prohibit drawing money out from a client account other than in accordance with rule 7 the effect of which is to restrict withdrawals to money paid out on the client's authority. However there are occasions when a balance remains in a client account and the client either cannot be traced or for some reason has not given consent to the closing of the account. Such a balance remaining in the account can create problems in the audit of the solicitor's accounts or closure of the practice.

The Council is empowered under rule 8 of the Solicitors' Accounts Rules to authorise the withdrawal of moneys from client account in appropriate circumstances not least of which is the requirement for the solicitor to give a written explanation of the steps that he has taken to locate the client in whose favour the balance remains on the account.

The Council decided that in future it will give directions for withdrawal from the accounts of clients who cannot be traced by directing that the outstanding balance be paid into a special account opened by the Law Society of Hong Kong designated for receipt of such unclaimed money subject to an undertaking to be given by the Law Society to repay any bona fide claimant on demand.

6.4 BANKING OF CLIENTS' MONEY

Some solicitors' firms use the ATM or cheque/cash deposit machines as a convenient and efficient way to bank clients' money. It should be noted that neither ATM nor cash deposit machines accept coins. In cases where a solicitors' firm receives client's money which includes dollars and cents, the firm should not round off the sum with office money and deposit it into the client bank account through an ATM or cash deposit machine as this will constitute a breach of Rule 4 of the Solicitors' Accounts Rules.

Solicitors' firms are recommended not to use ATM cards but should make use of the cheque/cash deposit machines to deposit clients' money into the client bank accounts. This is because these machines can only be used for depositing money. Further, no pin number is required to operate them; clients' money are deposited into the client bank account simply by using the deposit card or keying in the number of the account to be debited if no deposit card is available. ATM cards are generally issued with facilities to withdraw cash and to transfer money to other bank accounts which may put the firm at risk of clients' money being misappropriated if the card is misused. Office and client's money may be intermingled if an ATM card can access both the client and office accounts.

Solicitors' firms are reminded that they should always take necessary precautions to ensure that the clients' money is properly deposited and recorded according to the Solicitors' Accounts Rules.

APPENDICES

The attached appendices are examples of some possible formats. It should be noted that the formats contained in the examples are not the required formats. In reality, the formats depend to a large extent on the computer programmes used by the solicitors, and may differ from the samples given.

MANAGEMENT ACCOUNTS

It is good practice to prepare monthly management accounts. A sample of a set of management accounts comprising profit and loss account, appropriation account, balance sheet and notes to the accounts is as follows:

ABC SOLICITORS
MANAGEMENT ACCOUNTS
FOR THE YEAR ENDED 31 MARCH, Yr.2

<i>Contents</i>	<i>Pages</i>
Profit and loss account	1
Appropriation account	2
Balance sheet	3
Notes to the accounts	4-10

ABC SOLICITORS

Profit and loss account for the year ended 31 March, Yr.2

	Notes		Yr.2		Yr.1
		\$	\$	\$	\$
Professional income			x		x
Disbursement income			x		x
			<u>x</u>		<u>x</u>
Less: costs	2		(x)		(x)
Increase/(decrease) in work in progress			x		(x)
Interest income	3		x		x
Other income	4		x		x
			<u>x</u>		<u>x</u>
Expenses:					
Staff costs	5	x		x	
Office costs	6	x		x	
General expenses	7	x		x	
Professional charges	8	x		x	
Finance charges	9	x		x	
Depreciation and equipment charges	10	x	x	x	x
			<u>x</u>	<u>x</u>	<u>x</u>
Net profit for the year (to appropriation account)			<u>x</u>		<u>x</u>

[Page 1 of Management Accounts]

ABC SOLICITORS

Appropriation account for the year ended 31 March, Yr.2

	Yr.2	Yr.1
	\$	\$
Profit for the year (from profit and loss account)	x	x
Less: salaried partners' salaries	(x)	(x)
interest on capital	(x)	(x)
	<hr/>	<hr/>
	x	x
Appropriation:		
Partner A	x	x
Partner B	x	x
Partner C	x	x
	<hr/>	<hr/>
	x	x

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ABC SOLICITORS

Balance sheet as at 31 March, Yr.2

	Notes		Yr.2		Yr.1
		\$	\$	\$	\$
Fixed assets	11	x		x	
Investments	12	x		x	
Goodwill	13	<u>x</u>	x	<u>x</u>	x
Current assets					
Work in progress	14	x		x	
Debtors and prepayments	15	x		x	
Office bank account		x		x	
Cash in hand		<u>x</u>		<u>x</u>	
		<u>x</u>		<u>x</u>	
Current liabilities					
Creditors and accrued expenses	16	x		x	
Taxation	17	x		x	
Office bank account		<u>x</u>		<u>x</u>	
		<u>x</u>		<u>x</u>	
Net current assets			<u>x</u>		<u>x</u>
			x		x
Long-term liabilities					
Long/medium-term loans	18		(x)		(x)
			<u>x</u>		<u>x</u>
Represented by:					
Partners' accounts			<u>x</u>		<u>x</u>
Clients' accounts					
Bank accounts			<u>x</u>		<u>x</u>
Ledger accounts			<u>x</u>		<u>x</u>

[Page 3 of Management Accounts]

ABC SOLICITORS

Notes to the accounts for the year ended 31 March, Yr.2

1. Accounting policies

(a) Basis of preparation

These accounts have been prepared under the historical cost convention using the following accounting policies consistently applied.

(b) Fees receivable

Fees receivable comprises work billed to clients, up to 31 March each year.

(c) Notional expenses

Charge is made in profit and loss account for the notional interest on each partner's capital account, at 5% p.a.

All notional interest are reversed prior to appropriation of profit by the partners.

(d) Goodwill

Goodwill is carried in the accounts based on the agreed value of the goodwill at 31.3.Yr.1 of the individual firms of AB & Co. and C & Co., prior to their merger on 1.4.Yr.1. Goodwill is being written off in equal instalments over 10 years, that being the partners' estimate of its economic life.

(e) Capitalisation of assets

With the exception of lease premiums paid, all assets with a purchase price in excess of \$X are capitalised as fixed assets. Lease premiums paid are written off on being paid.

(f) Depreciation

Depreciation is provided to write off the cost, less estimated residual value, of all tangible fixed assets, other than freehold land and buildings, over their expected useful lives. It is calculated using the following rates:

short leasehold property and improvements	equally over the life of the lease
furniture and equipment	15 per cent per annum
computer equipment	33.3 per cent per annum
motor vehicles	25 per cent per annum

[Page 4 of Management Accounts]

(g) Leases

Where assets are financed by leasing agreements that give rights which approximate to ownership, the assets are treated as if they had been purchased outright. The amount capitalised is the present value of the minimum lease payments payable over the term of the lease. The corresponding leasing commitments are shown as amounts payable to the lessor. Depreciation on the relevant assets is charged to the profit and loss accounts.

Lease payments are analysed between capital and interest components so that the interest element of the payment is charged to the profit and loss account over the period of the lease and represents a constant proportion of the balance of capital repayments outstanding. The capital part of the instalment reduces the amounts payable to the lessor.

All other leases are treated as operating leases. Their annual rentals are charged to the profit and loss account on a straight line basis over the term of the lease.

(h) Work in progress

Work in progress comprises non-partner professional time costs, excluding any mark-up, plus disbursements, and excluding any non-recoverable work in progress.

(i) Debtors

Debtors include amounts billed as at 31 March each year.

(j) Bad debts

Debts, in excess of 120 days old are provided in full.

(k) Taxation

Taxation is provided on the full provision basis, in that account is taken of the liability to taxation in respect of all accounting periods ending on the current balance sheet dated.

(l) Deferred tax

Deferred tax is not provided in the accounts.

(m) Pension costs

Contribution to the firm's defined benefit scheme are charged to the profit and loss account so as to spread the cost of pensions over employees' working lives with the firm.

Contributions to the firm's defined contribution scheme are charged to the profit and loss account in the year in which they become payable.

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2	Costs	Yr.2	Yr.1
		\$	\$
	Disbursements	x	x
	Draftsmen charges	x	x
		<u>x</u>	<u>x</u>
3	Interest income	Yr.2	Yr.1
		\$	\$
	Interest income on bank accounts: client's general office	x	x
	Less: interest paid to clients	x	x
		<u>(x)</u>	<u>(x)</u>
	Other interest	x	x
		<u>x</u>	<u>x</u>
4	Other income	Yr.2	Yr.1
		\$	\$
	Rental income	x	x
	Sundry income	x	x
		<u>x</u>	<u>x</u>
5	Staff costs	Yr.2	Yr.1
		\$	\$
	Professional staff: salaries	x	x
	insurance	x	x
	pension costs	x	x
	Administration staff: salaries	x	x
	insurance	x	x
	pension cost	x	x
	Staff welfare and other costs	x	x
	Training	x	x
	Secretarial fees	x	x
		<u>x</u>	<u>x</u>

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6	Office costs	<u>Yr.2</u>	<u>Yr.1</u>
		\$	\$
	Rents	x	x
	Rates	x	x
	Service charges	x	x
	Lighting and heating	x	x
	Repairs and maintenance	x	x
	Office cleaning	x	x
	File storage	x	x
	Insurance	x	x
	<u>x</u>	<u>x</u>	
7	General expenses	<u>Yr.2</u>	<u>Yr.1</u>
		\$	\$
	Telephones/fax	x	x
	Postage and document exchange	x	x
	Printing and stationery	x	x
	Advertising and promotions	x	x
	Subscriptions	x	x
	Books and publications	x	x
	Travelling expenses	x	x
	Entertaining expenses	x	x
Miscellaneous	x	x	
	<u>x</u>	<u>x</u>	
8	Professional charges	<u>Yr.2</u>	<u>Yr.1</u>
		\$	\$
	Accountancy	x	x
	Public relations	x	x
	Professional indemnity insurance	x	x
	Practising certificates	x	x
	<u>x</u>	<u>x</u>	
9	Finance charges	<u>Yr.2</u>	<u>Yr.1</u>
		\$	\$
	Bad and doubtful debts	x	x
	Bank charges	x	x
	Bank loan interest	x	x
	Overdraft interest	x	x
	<u>x</u>	<u>x</u>	
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10 Depreciation and equipment charges						Yr.2	Yr.1
						\$	\$
Equipment hire and maintenance						X	X
Motor vehicle charges						X	X
Depreciation: short leasehold property						X	X
computer equipment						X	X
fixture and fittings						X	X
motor vehicles						X	X
Amortisation of goodwill						X	X
						<u>X</u>	<u>X</u>
						<u>X</u>	<u>X</u>
11 Fixed assets							
	Freehold property	Short leasehold property	Fixture & fittings	Computer equipment	Motor vehicles	Total	
	\$	\$	\$	\$	\$	\$	
Cost:							
Balance at 1 April Yr.1	X	X	X	X	X	X	
Additions	X	X	X	X	X	X	
Disposals	X	X	X	X	X	X	
Cost at 31 March Yr.2	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>	
Depreciation							
Balance at 1 April Yr.1	X	X	X	X	X	X	
Provided in year	X	X	X	X	X	X	
On disposals	X	X	X	X	X	X	
Depreciation at 31 March Yr.2	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>	
NBV at 31 March Yr.2	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>	
NBV at 31 March Yr.1	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>	

12	Investments	<u>Yr.2</u>	<u>Yr.1</u>
		\$	\$
	Investment in AGB Limited	x	x
13	Goodwill	\$	
	Balance as at 1 April Yr.1 (cost \$x)	x	
	Amortisation charge for the year	(x)	
	Written down value at 31 March Yr.2	x	
14	Work in progress	<u>Yr.2</u>	<u>Yr.1</u>
		\$	\$
	Time costs	x	x
	Disbursements	x	x
		x	x
15	Debtors and prepayments	<u>Yr.2</u>	<u>Yr.1</u>
		\$	\$
	Fees rendered at year end	x	x
	Fees rendered after year end in respect of matters completed at year end	x	x
	Insurance	x	x
	Rent and rates	x	x
	Interest receivable	x	x
	Subscriptions	x	x
	Amounts owed by former partners	x	x
	Other debtors	x	x
	Loaned to AGB Limited	x	x
		x	x
16	Creditors and accrued expenses	<u>Yr.2</u>	<u>Yr.1</u>
		\$	\$
	Salary	x	x
	Amount owed to former partners	x	x
	Motor, travel and entertaining	x	x
	Rent, rates and service charges	x	x
	Loan instalments (falling due within one year)	x	x
		x	x

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17	Taxation	<u>Yr.2</u>	<u>Yr.1</u>
		\$	\$
	Provision for Yr.1		x
	Provision for Yr.2	x	
		<u>x</u>	<u>x</u>
18	Long/medium-term loan	<u>Yr.2</u>	<u>Yr.1</u>
		\$	\$
	10-year loan, from September Yr.1	x	x
	Less: current instalments	(x)	(x)
		<u>x</u>	<u>x</u>
19	Commitments under operating leases		
	As at 31 March, Yr.2, the firm had annual rental commitments under non-cancellable operating leases as follows:		
		<u>Yr.2</u>	<u>Yr.1</u>
		\$	\$
	On equipment	x	x
	On short leasehold property	x	x
20	Contingent liabilities		
	At 31 March Yr. 2 the firm had guaranteed the borrowings of certain entities which amounted to the following:		
		<u>Yr.2</u>	<u>Yr.1</u>
		\$	\$
	AGB Limited	x	x

Appendix 2

USEFUL ACCOUNTING POLICIES

1. Basis of preparation
These accounts have been prepared on an accrual basis. There is no provision restricting the basis to be adopted for a firm's accounting policy. Note should however be taken in respect of the position taken by the Inland Revenue Department and the Hong Kong Solicitors Indemnity Fund Limited. It is recommended that a firm's accounts be prepared on an accrual basis.

2. Fees receivable
Fees receivable comprises work billed to clients in respect of completed matters up to 31 March each year.

OR

Fees receivable comprises work billed to clients in respect of completed matters together with interim bills up to 31 March each year.

OR

Fees receivable comprises work billed to clients, up to 31 March each year, exclusive of work billed after 31 March each year in respect of matters completed at 31 March.

3. Notional expenses
Charge is made in the profit and loss account for the following expenses:
 - Notional rent, being a charge for the market rent on the freehold premises at XX Road/short leasehold premises at XX Road the actual rent on which is below market levels.
All notional expenses are reversed prior to the appropriation of profit by the partners.

4. Foreign currency
Foreign currency transactions of the firm are translated at the rate ruling on the date on which they occurred. Foreign currency monetary assets and liabilities, including assets denominated in a foreign currency and loans taken out specifically to finance that asset in that currency, are translated at the rate ruling at the balance sheet date. All differences are taken to the profit and loss account.

5. Goodwill

No account is taken of goodwill in these accounts.

OR

Goodwill is carried in the accounts at a value of \$X, which was the value placed on goodwill by the partners as at 1.4.X1. Goodwill is not written off.

6. Capitalisation of assets
All assets with a purchase price in excess of \$X are capitalised as fixed assets.
7. Leases
All leases are treated as operating leases regardless of their terms. Their annual rentals are charged to the profit and loss account on a straight line basis over the term of the lease.
8. Work in progress
Work in progress is not recognised in the accounts.

OR

Work in progress comprises the cost of professional staff for the three months to 31 March each year, plus disbursements.

OR

The increase in work in progress comprises the increase from one year to the next of professional staff costs charged in the accounts.

OR

Work in progress comprises non-partner professional time costs, less any progress bills, excluding any mark-up, plus disbursements, and excluding any non-recoverable work in progress.

OR

Work in progress comprises non-partner professional time costs excluding any mark-up, plus disbursements, less any progress bills and excluding any non-recoverable work in progress.

OR

Work in progress comprises non-partner professional time costs, excluding any mark-up (except in the case of matters completed by the

year end) plus disbursements, and excluding any non-recoverable work in progress.

9. Debtors
Debtors include amounts billed as at 31 March each year together with any amounts capable of being billed as at that date.

10. Taxation
Taxation is not provided in the accounts.

OR

Taxation has been provided at the rate of x% on the estimated assessable profit for the year.

11. Deferred tax
Deferred tax is not provided in the accounts. The unprovided amount of deferred tax is not disclosed.

OR

Provision is made for timing differences between the treatment of certain items for taxation and accounting purposes to the extent that it is probable that a liability or asset will crystallise. Any unprovided deferred tax is separately disclosed.

DISBURSEMENTS

INTRODUCTION

A solicitor must render a bill of costs within a reasonable time from completion of the work. The bill should contain sufficient information regarding the work undertaken and should distinguish between profit costs and disbursements. In order to ascertain billing and recoveries and to control work in progress, besides the time recording system. The disbursement recording system described below is represented by a separate office column in the client ledger for each client. The total amount of office column balances of all clients' ledger accounts will be treated as part of the work in progress under current asset in the management account as mentioned in Appendix 1.

A. What is disbursement?

When billing a client for expenses incurred as disbursements, the following should be noted:

- the charge to the client is equal to the amount paid or payable to a third party by the practice;
- Commentary 2 of Principle 4.10, the Hong Kong Solicitors' Guide to Professional Conduct Volume 1 (2nd edition) states that a bill should show disbursements separately from profit costs.

B. Treatment of expenses qualified as disbursements

In order to have a clear interpretation of monies draw out from clients' account in respect of disbursement incurred by a solicitor firm, it is recommended that the disbursements should be classified under "disbursement spent or to be spent by solicitors as Principal or Agent",

a. Disbursement spent or to be spent by solicitors as principal:

1. Solicitors may incur a "traditional disbursement". This is an expense incurred by the solicitor as a principal and which the solicitor is primarily liable for the payment to a third party (i.e. the expense invoice is made out in the name of solicitors firm), but which is to be reimbursed by the client as part of the disbursements

Examples of disbursements incurred as principal are:

- (a) Counsel's fees;
- (b) Telephone charges;
- (c) Photocopying charges;
- (d) Courier costs;
- (e) Postage;
- (f) Costs for travel by the solicitor;
- (g) Restaurant charges;
- (h) Fees for search reports;
- (i) Fees for the taxation of bills of costs.

2. Accounting treatment:

These disbursements should generally be paid out from the office bank account and should only be recovered from the client account after a bill has been issued under rule 7 (a)(iv) AND/OR the client has authorized the transfer under rule 7 (a)(iii).

Example 1:

A solicitor paid a search fee of HK\$500 on behalf of his client, Mr. A

- (a) Debit the client's ledger account office column with HK\$500 for the amount of search fee.
- (b) Credit the office bank account with the same amount.

When a bill is sent to Mr. A, the amount will be shown as disbursement, separate from profit costs in the bill.

b. Disbursement spent or to be spent by solicitors as agent:

- 1. A solicitor (like any other agent) may purchase goods or services for a client, such as paying a business registration fee (i.e. B.R. fee). In these cases, the goods or services are supplied to the client, not to the solicitor who merely acts as an agent to make the payment.

Examples of disbursement incurred as agent:

- (a) Fees for the issue of incorporation certificates;
- (b) Fees for reservation of firm names;
- (c) Expert witness fees;
- (d) Court reporters' fees;

2. Accounting treatment:

Disbursements incurred by a solicitor as agent are essential expenditure on behalf of the client. The disbursements can be paid from the client account if such client has funds held on account.

Example 2:

A solicitor paid B.R. fee of HK\$20,000 on 01/01/02 on behalf of his client, Mr. A

This transaction can be recorded in two ways:

- (a) If Mr. A has money held in client account for payment:
 - (i) Debit the client's ledger account client column with HK\$20,000 for the amount of B.R. fee.
 - (ii) Credit the client bank account with the same amount.

- (b) If Mr. A has no money held in client account for payment:
 - (i) Debit the client's ledger account office column with HK\$20,000 for the amount of B.R. fee.
 - (ii) Credit the office bank account with the same amount.

The B.R. fee can be settled from the client account directly when the client has money deposited in client account later in accordance with rule 7 (a)(ii) of the Solicitors' Accounts Rules.

C. Treatment of expenses which are not qualified as disbursements

1. Expenses which do not qualify as disbursements under Part A above are considered as the solicitors' own expenses. Such expenses can be included as profit costs in a bill to a client if the solicitor is able to relate the expenses to a specific client through his internal administrative system. Examples of such expenses are charges for services provided to a client by staff of a firm, including despatching, photocopying or faxing services.

2. Accounting treatment:

Example 3:

A solicitor paid an employee of his firm HK\$1,000 petty cash as travelling expenses incurred in Jan/02.

This transaction can be recorded in two ways:

- (a) If the solicitor is able to relate a specific amount of such expenses to a specific client:

- (i) Debit corresponding clients' ledger accounts office column with the amount of travelling expense.
- (ii) Credit the petty cash account with the same amount.

When a bill is sent to the client, the solicitor will treat the travelling expenses as part of the profit costs.

- (b) If the solicitor is unable to relate a specific amount of such expenses to a specific client:
 - (i) Debit the travel expenses account (Profit and loss item) with HK\$1,000.
 - (ii) Credit the petty cash account with the same amount.

Example 4:

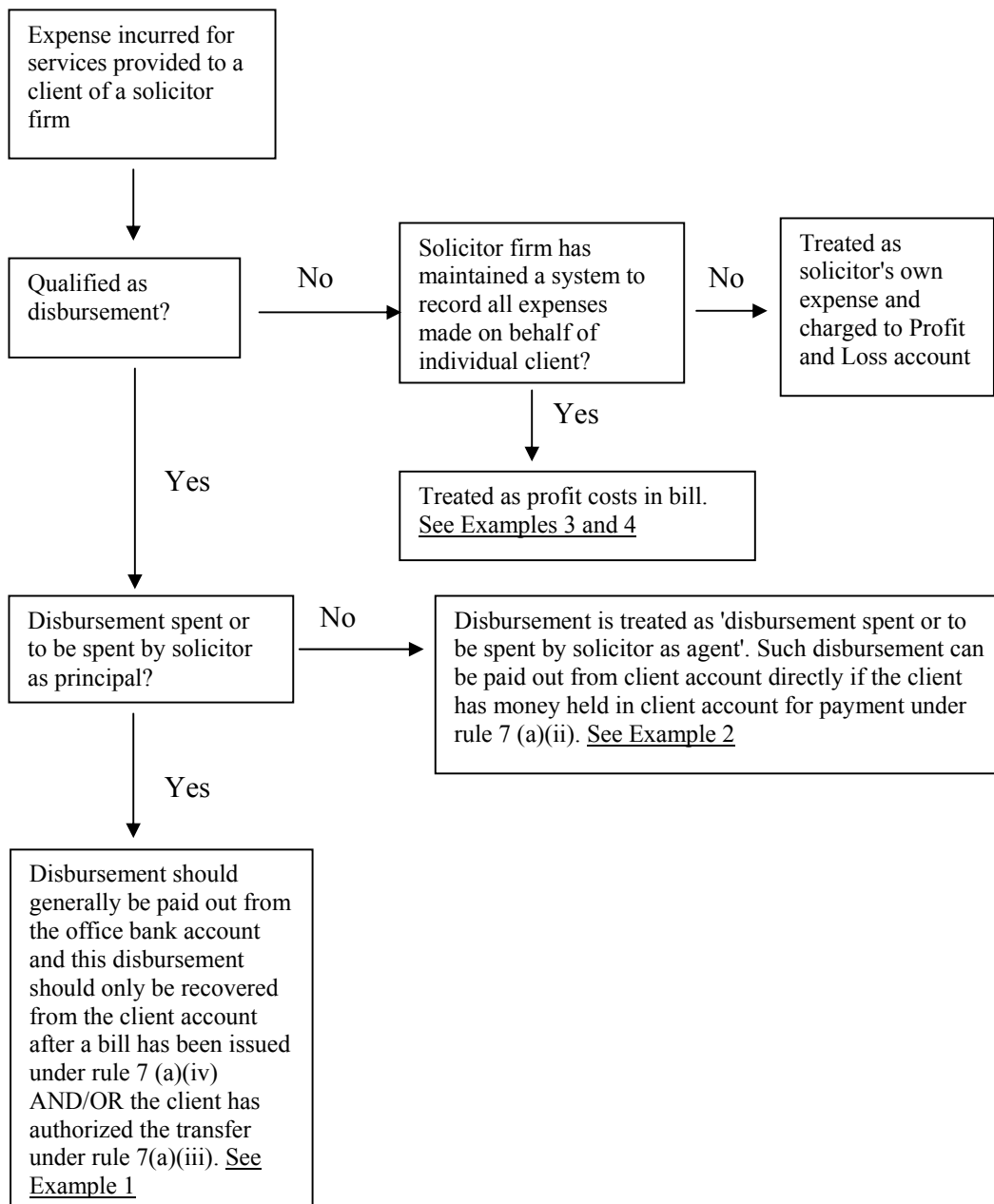
If a solicitors' firm maintains a register for photocopying, fax charges and sundry items charged to clients, and the firm has not paid out such charges from its petty cash:

This transaction can be recorded in two ways:

- (a) If the solicitor is able to relate the expenses to a specific client:
 - (i) Debit corresponding clients' ledger accounts office column with the amount recorded in the register.
 - (ii) Credit the sundry income (Profit and loss item) with the total amount recorded in the register.

When a bill is sent to the client, the solicitor will treat the amount as part of the profit costs.

- (b) Record the charges in the client's file clearly and charge to the client as part of the profit costs when a bill is issued.



Decision chart for classification of expense spent or to be spent by a solicitor

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