Technology and Compliance Auditing – The Future of Legal Regulation

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The best way to predict the future is to invent it.
Peter Drucker

Over the past few decades we as a society have witnessed considerable developments in trade, foreign direct investment, capital flows, migration, and technology to the extent that national boundaries have gradually diminished in importance. The fall of barriers has simulated free movement of capital and paved the way for companies to set up global businesses resulting in entities with profits as large as the gross domestic incomes of third world countries.\(^1\) The incidence of global institutions is not however limited to transnational corporations alone. Globalisation has also led to significant growth in the legal services marketplace both in Australia and overseas.\(^2\) In conjunction with the growth of law firms there has also been a strong growth in trade in transnational legal services.\(^3\) The practice of law is today becoming big business. As a result major structural changes are now occurring within the legal marketplace. Whilst a number of law firms have expanded establishing offices in more than one jurisdiction to ensure greater global coverage, a number of other law firms have avidly taken advantage of recent legislation in jurisdictions that permits incorporation and public listing.

\(^1\) In 2001, General Electric for example had revenues of $126 billion, more than the combined national incomes of sub-Saharan African countries, except the Republic of South Africa see John Madeley, Transnational Corporations and developing countries: big business, poor peoples, the Courier ACP_EU No. 196, January-February 2003.

\(^2\) A consolidated list of global law firms published annually and based on research survey compiled by The America Lawyer in the U.S. and Legal Week in the U.K. lists 100 law firms as achieving “global status: The Global 100 is a list produced by the American Lawyer which ranks the world’s highest-grossing firms see ‘The Global 100’ list available at www.law.com.

\(^3\) In Australia legal services are today a significant component in the export of professional and technical services. Statistics reveal that Australian exports of legal services have grown from SAU 74 million in 1987/88 to about SAU 250 million in 2000/01. See Australian Legal Services Export Development Strategy 2003 to 2006, ILSAC, March 2003 available at www.law.gov.au/ilsac; Australian Bureau of Statistics, Legal Services Industry.
In NSW for example, there are now more than 800 incorporated legal practices (ILPs). These ILPs are primarily located in the suburbs of Sydney and in the CBD\(^4\) and comprise of three or less practitioners. In addition to the establishment of these ILPs, one law firm has franchised their practice\(^5\) whilst another has adopted a limited partnership model and two law firms have already gone public and listed on the Australian Stock Exchange (ASX).\(^6\) Anecdotal evidence suggests however that this is only the beginning with interest in pursuing alternate business structures growing by the minute. This wave of change is not without repercussions. As the legal world aligns itself more closely with the business world cracks have begun to emerge threatening the ethical obligations of a once solid profession.

Commercialization by its very nature increases the pressure on firms to consider the profit motive as a superior business objective. This has profound implications for the legal profession whose duty to the court and the client has always been paramount. Professionalism speaks of ethically minded conduct and duties to the court, all of which may be antithetical to business objectives. These completing obligations not only have implications for law firms themselves but also for legal regulators who are charged with regulating the profession. As the regulator of legal practices in NSW, the OLSC has thus been forced to revise its role to ensure that its regulatory framework responds effectively to this change.

The OLSC has responded to this challenge by augmenting the traditional complaints-based paradigm with a new regulatory framework that utilises compliance-based mechanisms such as “practice reviews.”\(^7\) These practice reviews are, by and large, audits but unlike traditional audits, the OLSC’s practice reviews are not focused solely on financial or practice issues, but can be much broader. They are trigger-based and the triggers are not limited solely to a formal complaint. The benefit of this approach is that the OLSC can focus on entrenching

\(^4\) There are at present 344 ILPs practising in suburban Sydney and 251 ILPs practising in the CBD. Statistics from the Law Society of NSW, as at 1 April 2008.

\(^5\) This law firm operates through a group of independent branch offices throughout New South Wales, the ACT and Queensland. Each branch office is an ILP and is related to the law firm but not to each other, as is typically the nature of franchises. The law firm has to date entered into a franchise agreement with over 20 branch offices.

\(^6\) On 21 May 2007, Slater & Gordon an ILP made legal and corporate history when it became the first law firm in the world to list its whole firm on the ASX. Following Slater & Gordon’s listing, Integrated Legal Holdings (IHL), a Western Australian based law firm, listed on the ASX on 17 August 2007. Prior to Slater & Gordon’s listing in March 2004, Noyce Legal, a Sydney based law firm, listed its banking and finance division of its practice on the ASX. Noyce Legal did not list the whole firm but incorporated the division which specialised in residential mortgage processing, into National Lending Services Ltd (NLS) and sold all of its shares to listed consumer finance website Infochoice.

\(^7\) The power to conduct an audit (practice review) is proscribed in the Legal Profession Act 2004: see sections 140(3) and 670 of the LPA 2004.
and promoting ethical behaviour and not profit alone while encouraging the profession to remain a true profession as well performing as a business. In adopting this approach the OLSA is fostering a positive cultural change, which will in turn hopefully effect a corresponding positive behavioural change.

**Globalisation and structural changes in the Australian legal services marketplace**

The effects of globalisation on the legal services marketplace have been widely documented.\(^8\) We are now witnessing the emergence of the “global lawyer.” The global lawyer is no longer confined to the jurisdiction in which he/she had been educated and qualified. This global lawyer works in many different jurisdictions throughout the world and must understand the cultural, political and social differences each legal system enjoys. This global lawyer can provide sophisticated and specialized legal services to individuals and corporate clients of all sizes anywhere in the world. While still small in number these lawyers are at the forefront of change that is fundamentally changing the profession, or as some have argued, hastening its demise.

In conjunction with the emergence of the global lawyer we are also witnessing the emergence of the “global client” and the growth of client power.\(^9\) The global client is sophisticated, their expectations are immediate and they expect effective results. Global clients demand more from their lawyer, as their dealings are no longer confined to their home jurisdiction. The global client thus demands local access to legal solutions in multiple jurisdictions and practice areas. Today’s global clients are drawn to providers who offer one-stop shopping and often a broad range of professional services.\(^10\) The legal services marketplace is now responding to this demand by enacting legislation in some jurisdictions to permit law firms to

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adopt alternate business structures to the traditional partnership model that had dominated yet, in the view of many, restricted legal practice for so long.\textsuperscript{11}

In 2001 for example, New South Wales passed legislation permitting the creation of incorporated legal practices (ILPs), which could also include multidisciplinary practices (MDPs).\textsuperscript{12} The legislation permitted legal service providers to register as a company with the Australian Securities and Investments Commission (ASIC), the agency responsible for ensuring compliance with the Federal Corporations Act 2001 (Cth) (Corporations Act). Once so incorporated, the company was obliged to abide by its constitution, the Act and Regulations and the Corporations Act. In 2004 the Legal Profession Act 1987 through which the 2001 amendments permitted incorporation was replaced by the Legal Profession Act 2004 (LPA 2004). The 2004 provisions permitting incorporation remained largely unchanged. Identical legislation has also been adopted in a number of other jurisdictions across Australia.\textsuperscript{13}

Pursuant to the LPA 2004 a legal service provider may incorporate and provide legal services either alone or alongside other service providers who may, or may not be “legal practitioners.” The legislation however provides that at least one legal practitioner director\textsuperscript{14} (LPD) must be appointed.\textsuperscript{15} The LPD is responsible for the management of the legal services provided in NSW by the ILP.\textsuperscript{16} Such management, which is discussed later in the paper includes, inter alia, a requirement that the LPD implement and maintain “appropriate management systems.” According to the legislation it is an offence if an incorporated legal

\textsuperscript{11} New South Wales has openly embraced the right of law firms to establish multidisciplinary partnerships and incorporated legal practices. This has been made possible by amendments to the Legal Profession Act 1987 (NSW), the Legal Profession Amendment (Incorporated Legal Practices) Act No. 73 (NSW) and the Legal Profession Amendment (Incorporated Legal Practices) Regulations (NSW). Incorporated legal practices are also permitted in Victoria, Tasmania, South Australia and the Northern Territory.

\textsuperscript{12} The Legal Profession (Incorporated Legal Practices) Act 2000 (the Act) and the Legal Profession (Incorporated Legal Practices) Regulations 2001 (the Regulations) entered into force on 1 July 2001.

\textsuperscript{13} At present Victoria, Queensland and Western Australia all have identical legislation to that in NSW permitting incorporation. South Australia, Tasmania and the Australian Capital Territory have not yet enacted legislation permitting the incorporation of law firms but have undertaken to do so by the end of this year. The adoption by all jurisdictions of the NSW model will ensure harmonisation of practices and procedures and represents an important step towards the establishment of a national legal profession, which the OLSC as well as other regulators across Australia are working tirelessly to achieve.

\textsuperscript{14} A legal practitioner director is defined as a director of an incorporated legal practice who is an Australian legal practitioner holding an unrestricted practicing certificate.

\textsuperscript{15} Section 140(1) of the LPA 2004.

\textsuperscript{16} Section 140(2) of the LPA 2004.
practice does not have any LPDs for a period exceeding seven days and the practice may be forced into administration.\textsuperscript{17}

There has been a growing interest by law firms in New South Wales of the prospect of following the path to incorporation and beyond. However the implications of the introduction of such legislation are considerable. Incorporation brings with it both benefits and challenges to law firms. By contrast to partnerships, incorporation is seen to protect directors of a firm through the benefit of limited liability. Incorporation can also provide taxation benefits, grants the drafters of the company constitution flexibility regarding ownership, control and distribution of profits and can constitute a profitable investment for shareholders. Share transferability gives owners and other shareholders, who may be non-lawyers, greater flexibility by comparison with partnerships in their financial relationship to the firm. Non-lawyer directors may make valuable contributions to the operations of a company, providing speciality expertise. Incorporated legal practices avoid the requirement of partnerships to reconstitute themselves on the death, retirement or withdrawal of a partner. In addition, whereas non-performing partners may have only been exorcised from a practice through litigation, in an ILP they need only be voted off the board. Incorporation provides for greater flexibility in how employees are rewarded for productivity and that may contribute to a greater corporate camaraderie.

Law firms considering the shift to incorporation must however also consider the impact of the relatively rigorous reporting requirements of the Corporations Act and in the case of listing, the rules of the Australian Stock Exchange (ASX). Law firms must also consider that a breakout of increased industrial democracy, which may result from the creation of a more vertical structure, may diffuse decision-making and that remuneration may follow merit, rather than disproportionately reward seniority. Law firms must also consider that through the process of incorporation - they may cede authority for the ownership and management of the practice. The competing obligations of a listed legal practice to its clients and to shareholders presents a tension that will test the sufficiency of the legal regime. This tension is made more apparent if we consider the distinct financial advantages that incorporation has for potential

\textsuperscript{17} Section 142(1) of the LPA 2004.
shareholders and directors through more favourable taxation, superannuation and redundancy pay arrangements.\textsuperscript{18}

These challenges can have a profound effect on professionalism. Commercialised professionalism to which the business world adheres to and which the legal services marketplace has in effect moved towards, dictates that services should be tailored to meet the needs of the client or shareholder. Commercialised professionalism therefore emphasises the necessity of completing a task even if it violates traditional professional criteria stipulated in regulations.\textsuperscript{19} With the rise of the global client, lawyers are experiencing this tension more frequently than ever before. Consequently, the OLSC, as the regulator of legal practices in NSW, has thus been forced to reconsider and revise its role in the legal services marketplace and accordingly adjust its regulatory approach.

\textbf{Complaint based regulation}

The Office of the Legal Services Commissioner ("OLSC") receives complaints about solicitors and barristers in NSW. The OLSC works as part of a co-regulatory system, together with the Law Society of NSW and the NSW Bar Association to resolve disputes and investigate complaints about professional conduct. The primary function of the OLSC is, inter alia, "to regulate" the legal profession. The Oxford Dictionary defines the phrase "to regulate" as follows:

\begin{quote}
"1. Control, govern, or direct by rule or regulations; subject to guidance or restrictions; adapt to circumstances or surroundings...b. Bring or reduce (a person or group) to order ...2. Alter or control with reference to some standard or purpose; adjust (a clock or other machine) so that the working may be accurate...3. ...Exhibit regulation..."
\end{quote}

Historically regulators of the legal profession have adopted the "control and govern approach" and in fact this was the approach that was taken in NSW when the OLSC was first established in 1994. This approach traditionally categorised as a "complaints-based approach" focused setting high ethical standards by holding practitioners against these

\textsuperscript{18} Mark, S., "A short paper and notes on the issue of listing of law firms in New South Wales", presented to the Joint NOBC, APRL and ABA Centre for Professional Responsibility Panel, pp. 9-10, 2007.
standards and disciplining or removing those that failed. The approach is thus by and large a pass/fail system: either the rules are found to have been broken or they are not. Consequently, in the approximately 95 per cent of cases where there was insufficient evidence that a genuine breach of the conduct rules had occurred, the complaint was dismissed without any real attempt at problem solving or systemic improvement. This was one of the greatest problems of this approach.

Additionally this approach did not satisfy consumers of legal services. The overwhelming majority of people who lodge complaints against legal practitioners in NSW are simply not interested in a result whereby most complaints are dismissed or the legal practitioner gets disciplined. What consumers are after is the outcome they originally went to their practitioner for and failed to get. They want the conveyance to go through, the personal injuries action to finally get listed, the estimate for settlement to be in accordance with what they were originally told. They want the kids from the marriage, they want to get out of jail. In short, they want "justice" as they see it.

The second problem with this approach is that it was ad hoc and reactive, and thus triggered only in response to problems that have already occurred. So a practitioner who had overcharged a complainant in a particular matter was only reprimanded in respect of that particular matter even though that practitioner may have engaged in a practice of overcharging. Similarly, a practitioner who had failed to disclose his/her costs in relation to one matter would be reprimanded in that particular matter even if that practitioner had continually failed to disclose his costs in other matters he had acted for that particular complainant.

Third, the approach is narrow and secretive and is incapable of bringing about systematic change. The limitations of the disciplinary process meant that the practitioner would be disciplined only and there would be no guidance or assistance to educate the practitioner about not making the same mistake again.

Fourth, the traditional complaint-based regulatory regime focuses solely on individual conduct, that is conduct by an individual practitioner in a firm, not conduct by the firm itself.

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Law firms could not therefore be held to be vicariously liable for the actions of their employees. Critics have argued that sanctions against a law firm are possible and necessary to “encourage partners to invest in structural controls, such as conflicts checking procedures, to promote firm-wide compliance with professional regulation.”

These limitations appeared to be in stark contrast with the objectives of the regulatory system, which is to redress consumer complaints by users of legal services; ensure that individual practitioners comply with professional standards, and maintain the standards of the profession as a whole. The limitations similarly appeared to be in stark contrast with the vision and mission statement of the OLSC to “lead in the development of an ethical legal services market which is fairer, more accessible and responsive”, and reduce complaints by:

- Developing and maintaining appropriate complaints handling processes
- Promoting compliance with high ethical standards
- Encouraging an improved consumer focus in the profession;
- Developing realistic expectations by the community of the legal system.

The OLSC thus enhanced its complaint handling approach. The approach taken was that embodied in the second part of the definition of “to regulate” – being “to bring to order.”

The “bring to order” approach recognises that there are multiple aims to an effective regulatory system. These aims include a consumer dimension, with the consequent need to redress the complaints of dissatisfied users of legal services, a practitioner dimension, ensuring the diligence and competence of individual practitioners and a profession dimension, maintaining high standards of ethics and practice for the profession generally.

The “bring to order” approach to regulation is by contrast to the “control and govern approach” proactive, public and positive. It involves continually building, evaluating and improving our activities. The philosophy behind this approach is formulated on ensuring that the OLSC will make a lasting and significant contribution to raising standards in the legal

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services industry – to put the profession in better order so to speak – and ultimately to improve the satisfaction with the services delivered by legal practitioners to the community. The OLSC has sought over the years to invoke this approach in three ways; the capture and publication of knowledge, the education of practitioners and would-be practitioners, and the education of consumers and their representatives/agencies.

The “bring to order” approach has proven to be an undeniable success. This success is clearly reflected in the OLSC complaint statistics. During the first year of operation in 1994 the OLSC received 2,801 written complaints and 6,700 inquiry calls. In 2007-2008 the OLSC received 2742 written complaints and 9694 inquiry calls. Notwithstanding the increase in the number of inquiries received, the number of written complaints has remained virtually static. This is particularly impressive when we consider the increase in the number of the members of the legal profession from about 12,000 to about 25,000 for that period. Despite this success recent structural changes to the legal marketplace have once again forced the OLSC to reassess the dynamics of the “bring to order” approach.

**Compliance based regulation**

With the enactment of the 1987 and ensuing 2004 legislation permitting ILPs came a new range of additional responsibilities for legal practitioners who sought to incorporate. The usual professional obligations that complement the privileges enjoyed by Australian legal practitioners bound those practitioner employees and officers delivering legal services on behalf of an ILP. However these responsibilities were extended in the case of legal practitioner directors of an ILP to include obligations under the Corporations Act as well as:

(i) A general responsibility on the solicitor director for management of the legal services provided by the incorporated legal practice - this responsibility probably does not extend beyond those general responsibilities that partners have to the general management of their partnership.

(ii) The implementation and maintenance of “appropriate management systems” to enable the provision of legal services in accordance with the professional obligations of solicitors and the other obligations imposed by or under section 140(2) and (3) of the LPA 2004. Failure to implement and maintain “appropriate management systems” is declared to be professional misconduct.

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23 Section 143 of the LPA 2004
(iii) A responsibility to report to the Law Society any conduct of another director of the practice that has resulted in or is likely to result in a contravention of that person’s professional obligations or other obligations imposed by or under the Act.\textsuperscript{24}

(iv) Report to the Law Society any professional misconduct of a solicitor employed by the practice.

(v) An obligation to take all action reasonably available to deal with any professional misconduct or unsatisfactory professional conduct of a solicitor employed by the practice.\textsuperscript{25}

In order to effectively comply with these additional responsibilities the OLSC together with Law Society, LawCover (the provider of professional indemnity insurance in New South Wales), and the College of Law, the largest provider of continuing legal education in New South Wales developed an educational program which by and large puts in place a quasi “ethical infrastructure” – that is, formal and informal management policies, procedures and controls, work team cultures, and habits of interaction and practice that support and encourage ethical behaviour – for ILPs.\textsuperscript{26}

The ethical infrastructure is put in place by the requirement under section 140(3) of the LPA 2004 that a legal practitioner director must ensure that “appropriate management systems” are implemented and maintained by the ILP. Failure to implement an appropriate management system pursuant to the LPA 2004 may pursuant to the 2004 Act constitute professional misconduct. “Appropriate management systems” are not defined in the LPA 2004. The OLSC has however in collaboration with the Law Society of NSW, the College of Law and LawCover developed key criteria to ascertain whether an ILP has “appropriate management systems” in place. These key criteria set out below are what the OLSC considers to be the ten objectives of a sound legal practice:

1. Competent work practices to avoid negligence.
2. Effective, timely and courteous communication.
3. Timely delivery, review and follow up of legal services to avoid instances of delay
5. Shared understanding and appropriate documentation from commencement through

\textsuperscript{24} Section 140(4) of the LPA 2004.
\textsuperscript{25} Section 141 of the LPA 2004.
\textsuperscript{26} The term “ethical infrastructures” was developed by Prof Ted Schneyer. See “T. Schneyer, “A tale of Four Systems: Reflections on How Law Influences the “Ethical Infrastructure of Law Firms” (1998) 39 South Texas Law Review 245. It was developed further by Elizabeth Chambiss and David Wilkins in “Promoting Effective Ethical Infrastructure in Large Law Firms: A Call for Research and Reporting” (2002) 30 Hofstra Law Review 691 and “A New Framework for Law Firm Discipline” (2003) 16 Georgetown Journal of Legal Ethics 335
to termination of retainer covering costs disclosure, billing practices and termination of retainer.

6. Timely identification and resolution of the many different incarnations of conflicts of interest including when acting for both parties to a transaction or acting against previous clients as well as potential conflicts which may arise in relationships with debt collectors and mercantile agencies or conducting another business, referral fees and commissions etc.

7. Records management which includes minimizing the likelihood of loss or destruction of correspondence and documents through appropriate document retention, filing, archiving etc and providing for compliance with requirements as regards registers of files, safe custody, financial interests.

8. Undertakings to be given with authority, monitoring of compliance and timely compliance with notices, orders, rulings, directions or other requirements of regulatory authorities such as the OLSC, Law Society, courts or costs assessors.

9. Supervision of the practice and staff.

10. Avoiding failure to account and breaches of s61 of the Act in relation to trust accounts.27

A standard “self-assessment document” has been developed to enable legal practitioner directors to assess their management systems. This self-assessment document is sent to ILPs once the OLSC has received notification from the Law Society of NSW that a practice has incorporated. The self-assessment document takes into account the varying size, work practices and nature of operations of different ILPs, eschewing an inappropriate “one size fits all” approach requiring the fulfillment of uniform criteria. The self-assessment document instead suggests indicative criteria to assist legal practitioner directors to address each of the ten objectives along with examples of what an ILP may do that would provide evidence of compliance. For example, regarding “competent work practices to avoid negligence,” the self-assessment document suggests as a criterion that “fee earners practice only in areas where they have appropriate competence and expertise.” A “written statement setting out the types of matters in which the practice will accept instructions and that instructions will not be accepted in any other types of matters” would provide evidence that this criterion had been met. Legal practitioner directors then rate the ILP’s compliance with each of the ten objectives as either “Fully Compliant”, “Compliant,” “Non-Compliant” or “Partially Compliant.”

The OLSC has, in practice, by agreement with the Law Society, assumed the role of “auditing” ILPs for compliance with the LPA and Regulations pursuant to sections 140(3) of the LPA. The OLSC’s power to audit ILPs is found in section 670 of the LPA 2004, which provides as follows:

27 See the OLSC website at http://infolink/lawlink/olsc/ll_olsc.nsf/pages/OLSC_ilp
Compliance audit of law practice

1. The Law Society Council or the Commissioner may cause an audit to be conducted of the compliance of a law practice (and of its officers and employees) with the requirements of this Act, the regulations or the legal profession rules.

2. Without limiting subsection (1), an audit conducted in relation to an incorporated legal practice may include an audit of:
   (a) the compliance of the incorporated legal practice with the requirements of Part 2.6, and
   (b) the management of the provision of legal services by the incorporated legal practice (including the supervision of officers and employees providing the services).

Note. Section 140 (3) (Incorporated legal practice must have legal practitioner director) requires legal practitioner directors to ensure that appropriate management systems are implemented and maintained.

The OLSC's audit powers are reasonably new. In 2001 the LPA 1987 was amended to allow the OLSC and the Law Society Council to "conduct a review of the compliance of an incorporated legal practice (and of its officers and employees) with the requirements of or made under this Act in connection with the provision of legal services by the practice."28 The test for compliance was found in section 47E(3)(a) of the Act which stipulated that it was professional misconduct if a solicitor director did not ensure that appropriate management systems were implemented and maintained by the ILP.

The term "review" was not defined in the 1987 Act29. However it appears that it was defined to connote something similar to that of a compliance audit in so far as the regulations gave the OLSC power to examine persons, inspect books and hold hearings on the same terms as those powers have been conferred on the ASIC. The extent of the review power under the 1987 Act was thus very specific.

Five such reviews were conducted under the 1987 Act. These five reviews entailed a visit from the OLSC and review of the firm's ILP client files systems and accounting procedures. During each review, the solicitor-director was interviewed about the self-assessment document and asked a list of standard questions. After the interview the ILPs client files and accounting procedures were reviewed to determine the extent of compliance with the ten

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28 Section 47P of the LPA 2007.
29 "Review" is defined in the New Shorter Oxford English Dictionary as follows:

"2 The action of looking over a book etc. for the purpose of correction or improvement; revision; an instance of this...3 An inspection, an examination...4 A general survey or reconsideration of some subject or thing...5 Consideration of a judgment, sentence...6 An account or criticism of a (new or recent) book, play, film, product..."
objectives. Once the visit was complete the OLSC drafted a review report for the ILP in respect of its management systems.  

In 2004 the provisions of the LPA 1987 relating to ILPs and audits was greatly amended. Section 670, which replaced section 47P conferred a broad general power on the OLSC to audit all legal practices not just ILPs. Accordingly the LPA 2004 created two types of “audits.” The first is a general power to “audit” any law practice regardless of entity status pursuant to section 670(1) of the LPA 2004. The OLSC has characterised this type of an “audit” as a “compliance audit” in line with the wording of the provision. The second is an audit of an ILP which is broken into two components – Part 2.6 compliance and management of the provision of legal services (section 670(2)(a) & (b)) – an ILP audit.

The compliance audit: section 670 of the LPA 2004

Section 670 does not define the term “compliance audit” nor does it provide a test for compliance. This being so the OLSC has had to consider the concepts of “audit” and “compliance” and interpret them in accordance with the objects and purpose of the provisions.

Black’s Law Dictionary defines the term “audit” to mean

“A formal examination of an individual’s or organisation’s accounting records, financial situation, or compliance with some other set of standards”

Similarly, the New Shorter Oxford English Dictionary defines the term “audit” as follows:

“...A n. 1 An official examination and verification of (orig. orally presented) financial accounts, esp. by an independent body...2 A statement of account; a balance sheet...3 A hearing, an inquiry, a methodological and detailed review...4 A periodical settlement of accounts between landlord and tenants...5 A searching examination; a reckoning, a settlement.”

Each of these definitions are problematic for the OLSC because they appear to focus on financial records as a key activity of an audit. A similar notion is also expressed in the legal definition of an “audit”:

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These definitions have proved difficult for the OLSC. The OLSC was of the view that the power to conduct a compliance audit of a legal practice pursuant to section 670 of the LPA 2004 should not involve the OLSC conducting an audit of a practice’s accounting and financial records. The power to conduct a financial audit is however already dealt with under the LPA 2004 and is entrusted to the Law Society’s Trust Account Inspectors and or the financial audits required by the Corporations Act 2001. The OLSC is clearly of the view that section 670 audits under the LPA should not override provisions of the LPA with respect to the trust account inspectors whom the OLSC works closely with. This being so, the OLSC has recently adopted the term “practice review” rather than audit when discussing the power under section 670 of the LPA 2004 because a “practice review” has no implied financial connotations.

The OLSC is of the view that there are several objectives of a practice review under section 670 of the LPA 2004. Such objectives include as follows:

a) Support the provision of high quality, ethical legal services by practices;
b) Improve the process for regulating and improving ethical behaviour by practices;
c) Reduce complaints against practices;
d) Encourage levels of consistency and certainty to ensure higher levels of consumer protection;
e) Provide greater visibility of the compliance of practices;
f) Provide information on compliance to the OLSC aiding in the execution of responsibilities;
g) Monitor compliance of practices with their professional and ethical responsibilities;
h) Improve reporting and accountability by practices to the OLSC;
i) Validate information provided by practices;
j) Information dissemination;
k) Provide analysis of how practices are being run;
l) Assist practices in customisation of and alternate paths through self assessment and regulation;
m) Provide regulatory and educational information practitioners; and
n) Facilitate the adoption of good business practices and appropriate management systems in practices.

31 See Legal Thesaurus, William V. Burton, 2nd ed
The ultimate objective with respect to conducting a practice review is improved practice management and compliance with the LPA. As stated above the ILP audit refers to section 140(3), which stipulates that a legal practitioner director must ensure that appropriate management systems are implemented and maintained. A practice review is not so specific but is generic in that it refers to compliance with the LPA, the Regulations and the Professional Conduct and Practice Rules and is not limited to management systems. The OLSC has thus interpreted to mean that a practice review is event driven – that is the review is appropriate due to an event. The event may be a complaint, as is the case in the traditional complaints paradigm, but it can also be something other than a complaint such as a breaches that amount to either unsatisfactory professional conduct or professional misconduct. Such breaches can for example include, a breach pursuant to section 84(2) of the LPA 2004 regarding advertising\textsuperscript{32}, breaches of the costs disclosure provisions pursuant to sections 309-318 of the LPA 2004 or a breach of Regulation 5 of the Legal Regulations 2002.\textsuperscript{33}

The initiation of a practice review can also occur as a result of the following events:

a) Adverse media publicity;

b) A practitioner who has appeared on OLSC’s Complaint Tracking System more than once in 12 months (or the disciplinary register);

c) Referral from a Law Society trust account inspector;

d) A follow up compliance audit which is due as a result of a previous audits;

e) The practitioner has been listed in the Professional Conduct Committee reports; information provided by OLSC, Law Society, ASIC or

f) Any other source that is of concern or any other reason deemed appropriate by the Commissioner.

The OLSC’s concept of a practice review as set out above is similar to the way in which the NSW Auditor General conceptualises a practice audit:

\textsuperscript{32} Section 84(2) provides that a barrister or solicitor must not advertise in a way that might reasonably be regarded as (a) false, misleading or deceptive, or (b) in contravention of the Trade Practices Act 1974 of the Commonwealth, the Fair Trading Act 1987 or any similar legislation. A contravention of section 84(2) is capable of being professional misconduct or unsatisfactory professional conduct whether or not the barrister or solicitor is convicted an offence in relation to the contravention (sec. 84(3)).

\textsuperscript{33} Regulation 5 provides that a solicitor must not in the solicitor’s capacity as solicitor for a lender or contributor; (a) advance any money entrusted to the solicitor to a borrower for a run-out mortgage, or (b) do any work for the purpose of extending the term of a run-out mortgage, or (c) accept any money from a client for the purpose of advancing that money to a borrower for a run-out mortgage, or (d) do anything else with respect to a run-out mortgage in contravention of the regulations or the solicitors rules relating to run-out mortgages.
"A practice audit evaluates whether an organisation is effectively meeting its objectives, and using its resources economically and efficiently. It can cover all, or part of, the activities of an agency or agencies. These audits are undertaken in accordance with the provisions of section 15 of the Audit Act 1994 and are funded from parliament’s appropriation and, therefore, are not paid for by the agency audited.

Performance audit reports provide an independent assessment of an area of public sector activity and seek to improve resource management and add value to an agency through recommendations on improving operations and procedures. While recommendations from an audit can address improvements to operational methods, the Auditor-General cannot, and does not, question the merits of government policy."  

The OLSC is also looking at developing and using other methods of conducting practice reviews such as surveys such as those used by the Queensland Legal Services Commission and similar external methods. To this end the OLSC has thus been working closely with the other regulators to ensure harmonisation across all practices and procedures.

**The ILP audit: section 140(3) of the LPA 2004**

In addition to a general practice review under section 670 an ILP can also be subject to an ILP practice review. Like the general practice review, the ultimate objective of reviewing an ILP pursuant to section 140(3) is better practice management and compliance with the LPA. The objectives of an ILP practice review will allow the OLSC to evaluate the following factors in relation to the ILPs management systems:

a) Confirmation that appropriate management systems has been implemented and maintained by the ILP in accordance with section 140(3) of the LPA;

b) Ascerten whether any significant changes in management, organisation, policies, procedures, techniques or technologies are adversely affecting the management systems or welfare of the ILP in general;

c) Provide relevant guidance, explanations and examples of how similar matters and concerns have been dealt with by other ILPs;

d) Provide information on suitable and necessary training for staff or the LPD;

e) Track and analyse ILPs in the self assessment process;

f) Improve monitoring of the self assessment process for ILPs

g) Provide further information on relevant elements;

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34 The power to conduct a performance audit is found in section 38B, Division 2A of the Public Finance and Audit Act 1983. Pursuant to section 38B(1) the Auditor General of NSW may “conduct an audit of all or any particular activities of an authority to determine whether the authority is carrying out those activities effectively and doing so economically and efficiently and in compliance with all relevant laws.” “Audit” is defined in this section to mean “examination and inspection.”: see [http://www.audit.nsw.gov.au/info/about_us/role.htm](http://www.audit.nsw.gov.au/info/about_us/role.htm)
h) Determine the need for a follow up audit;

i) Confirm compliance with obligations under Part 2.6 of the LPA.

j) Align practice management with concerns following from a complaint history.

The same triggers that prompt the OLSC to conduct a practice review of a legal practice will also prompt the OLSC to conduct a practice review of an ILP. However in the case of an ILP practice review there are additional triggers and once again unlike the traditional complaints-based paradigm are not only limited to actual complaints. Such triggers may for example include if ILP fails to return a completed self-assessment form or if the LPD fails to warrant that the practice complies with the requirement to establish and maintain appropriate management systems or the LPD reports ratings less than compliant.

Other triggers may also include where there is evidence to suggest that the LPD has misled the Commissioner with respect to appropriate management systems or where the objectives remain rated less than compliant or an LPD or non LPD or a solicitor employee is listed in a cost warning or conflict of interest database or the most recent monthly Law Society or NSW Professional Conduct Committee Reports or the latest Law Society of NSW Inspection Itinerary. Similarly, a listing of the ILP in the OLSC’s top “30” repeat offenders list which is maintained by the OLSC; or an ILPs certification which has expired will also be a trigger.

Since 1 January 2008 the OLSC has conducted 4 practice reviews on ILPs as well as a number of less formal reviews. The four formal reviews were conducted on the ILPs for numerous reasons including a returned self assessment form with 7 of the 10 objectives rated as partially compliant, 35 a returned self-assessment form with all of the 10 objectives rated as non-compliant, a trust account inspection report which raised major issues with respect to supervision of employees and the veracity of the legal practitioner director’s certification that appropriate management systems had been established and maintained, 36 and an ILP which has been the subject of 65 complaints with 49 complaints being made since incorporation in

35 The ILP had previously completed a self-assessment form and was deemed compliant in around 2004. The OLSC asked the legal practitioner director to complete another form, as there had been a couple complaints about him that had given the OLSC cause for concern. As the ILP, which had been established for sometime, was only compliant with some of the objectives, an audit was appropriate.

36 Following the Trust Account inspection both the Law Society of NSW and the OLSC initiated complaints about the legal practitioner director (we subsequently took over the Law Society complaints). Around 9 complaints had been made about the legal practitioner director in the past and coupled with the findings of the inspection report an audit was conducted.
2003.\textsuperscript{37} We are also in the process of reviewing another ILP sole practitioner who has been the subject of over 100 complaints since that practitioner commenced practice.

All of the ILPs have responded reasonably positively to the reviews. Several were very nervous about the process but were still very accommodating. The OLSC decided that it would be beneficial for all concerned if we sent the ILPs a copy of the OLSC practice review workbook, which contains questions that we ask, before the review occurred. This gives the ILP time to prepare, formulate the answers to the questions and also obtain copies of any documents that we might request. This positive reaction to our reviews is largely because we take an affirmative, non-adversarial approach to the review and at all times emphasize that we are assisting and working with the ILPs.

The OLSC has characterised the general practice review and the ILP practice review process as a systematisation of ethical conduct. This approach sits well within the OLSC’s general philosophy of regulation that a regulator should:

(i) Ensure compliance with the relevant laws, rules and regulations;

(ii) Consistently questions those laws, rules and regulations both for relevance, and in assessing their impact upon both the profession and the community at large, and to make appropriate recommendations for change or improvement; and

(iii) Educate the profession and consumers of legal services with the goal of creating a culture within the profession whereby compliance itself becomes cultural. Once such a culture is achieved, it follows that there will be a reduction in the number of complaints received by my Office. In fact, it has been a long standing stated aim of my Office to reduce the number of complaints about lawyers.

In effect, what we are aiming to achieve, in New South Wales, is the creation of a new measure of ‘success’ for legal practices. Thus, those practices that have effectively implemented appropriate management systems and rate themselves compliant in all ten objectives can claim ‘success’. It is a measure that does not, indeed cannot, compete with a quarterly statement, but complements it. In so doing, it shifts the statistical analysis of legal business practice towards a greater balance between good business and good ethics. Measuring such success is a vital step to rewarding it and vital also to ensuring that the

\textsuperscript{37} This does not reflect our position that complaints about practitioners fall after a practice has incorporated. The OLSC asked the legal practitioner director to complete another self-assessment form. It was returned with all 10 objectives rated as compliant or fully compliant. Given the nature and number of complaints made, an audit was appropriate.
consumers of legal services can be confident that legal ethics have not been compromised by the shift to corporate business structures.

**Technology and risk profiling**

In order to manage the self-assessment process more effectively and efficiently, we are building an online Portal to automate the management and regulation of legal practices in NSW. The original scope of the project was to build a browser-based system specifically for ILPs in NSW to automate and replace much of the manual processing. The original system focused only on the regulation of ILPs through the self-assessment process. It has however become abundantly clear that it is necessary to amend the scope so that the OLSC has the potential and ability to include all practices in NSW in the system, not just ILPs. It was recognised that a more comprehensive system is required so that future requirements can be addressed. Accordingly, we are now building the Portal for all legal practices. The Portal’s features include:

- A database of legal practices’ and legal practitioners’ data and functions to maintain that data;
- A function to aid in information exchange between OLSC and external parties such as the legal practices and Law Society;
- A legal practices information and educational repository to assist legal practices improve their management systems;
- A function to automate the review, assessment and management of the self-assessment process; and
- A comprehensive set of operational and management reporting.

The Portal will improve the process for regulating and improving ethical behaviour by all legal practices and support the provision of high quality, ethical legal services. We envisage that this will in turn reduce the number of consumer complaints about the legal profession. The Portal will also enhance the application and technical capacity to address our need for complete, timely and accurate information to support decision making, whilst providing the most effective utilisation of OLSC resources. The Portal will further provide an information and educational repository to aid legal practices in improving their management systems, which will support the provision of high quality, ethical legal services by legal practices and the OLSC’s vision of education towards compliance.
One of the most important functions of the Portal will be its risk-profiling element. The use of risk profiling will assist the OLSC in focusing its resources on reducing complaints against practitioners by identifying those, which are most at risk of non-compliance or unprofessional conduct. The key outputs of the risk-profiling framework will include priority practice review recommendations as well as targeted education programs to assist firms that are not doing well to help them improve and assist firms that are doing well to do better.

The use of risk-profiling to better regulate the legal profession is an innovative but necessary move. We have engaged a specialist business strategy and management company to assist with the risk-profiling component of the project. The company we have contracted has developed a number of targeted strategies based on risk profiling and will assist us establish a risk-profiling framework. This framework will prioritise education programs and target practice reviews based on their risk of non-compliance or unprofessional conduct. The methodology used will support the effective conduct of practice reviews, maximise the opportunity to review operating practices and so minimise the opportunity for non-compliant practices to be missed. The Portal will draw upon both data from the Law Society database and the Complaints Tracking System currently used at the OLSC. Accordingly, the Portal will provide up-to-date information, which, inter alia, will enable risk profiling to be conducted on all NSW legal practices and legal practitioners. The risk-profiling element of the Portal will also allow the OLSC to rapidly acquire the data and the analytical capacity required to make evidence-based risk assessments and accordingly review which legal practices require regulation and attention. Risk profiling will further allow the OLSC to identify systemic risk factors for practice reviews; and further investigation and provide a framework to continue ongoing refinement and monitoring for non-compliant behaviours from legal practitioners.

**Conclusion**

The effects of globalisation on the legal services market has prompted legal practices to realise that in order for them to maintain their relevance that they must be versatile, innovative, and forward-thinking. Law firms in New South Wales have responded to this challenge in a number of ways. Many law firms have, for example, adopted new management structures to ensure certainty in billing and greater efficiency in service. Law firms have also
overcome their Luddite fear of technology and have welcomed its introduction in many facts of practice. In the courtroom, for example, technology has become a permanent fixture with the introduction of video-conferencing, electronic filing and real-time transcripts.\textsuperscript{38} Similarly, in practice, the use of technology is today more normal than not - most lawyers now Google regularly and have adopted Blackberry’s to ensure effective management control.

In order for a regulatory regime to maintain its relevance it must also be versatile, innovative, and forward thinking. The OLSC has thus been forced to review its traditional regulatory framework as a result of the structural changes in the legal marketplace to ensure that its methods and processes remain effective and relevant. As a result of the review the OLSC has now implemented new regulatory methods, which augments the traditional complaints-based regulatory system. This new system consists of performance reviews, “quasi” audits whereby the OLSC conducts a compliance review of a legal practice pursuant to section 670 and 140 of the LPA 2004. In effect the OLSC is using the structural changes to promote cultural change which it hopes will in turn lead to better behavioural change.

\textsuperscript{38} See A. Hoyle, The Court of the Future and its Lessons, Australian Law Librarian, Vol 12, No. 4 Summer 2004 at p. 45.