

ACCOUNTANCY FOR LAWYERS: CIVIL LAW vis-à-vis COMMON LAW SYSTEM

by

Rajiv Sawhney, Partner
Akshita Agarwal, Junior Associate

Overview

Accounting involves identifying, recording, classifying, summarizing, analysing business transactions, and interpreting results.¹ This crucial function is indispensable for every profession and business. Accounting serves as a comprehensive record, providing insights into financial status, aiding decision-making, assisting with taxation, informing about dues and balances, and ensuring effective management of assets, expenses, and borrowings.

For lawyers, systematic recording of daily transactions is not only a legal duty but also a practical necessity. Accurate accounting allows legal professionals to understand their financial standing and assess their performance. This systematic recording of transactions is what we refer to as accounting.

The primary purpose of accounting is to present a complete financial picture. Lawyers, who practice law for a fee and incur various expenses, engage in numerous financial transactions. Consequently, the legal obligation to maintain meticulous accounts becomes essential, ensuring transparency and accountability in their financial dealings.

According to the World Factbook, the world's legal systems are classified into five categories:² Civil, Common, Customary, Mixed or Pluralistic, and Religious law. Beyond these, an international legal system governs the interconnected relations among nations. Each legal system has its bar association that regulates legal professionals, including lawyers, advocates, and barristers. The professional conduct and accounting rules for each country's bar association vary.

This article focuses on the accounting practices of lawyers within two distinct legal systems out of the five. It compares the accounting practices of lawyers in Germany, representing the civil law system, and India, representing the common law system. The comparison aims to highlight how these different legal systems—codified civil law systems and precedential common law systems—influence the accounting practices of lawyers.

Legal Profession in Germany

In Germany, a lawyer is referred to as a “Rechtsanwalt” or “Rechtsanwältin” for a female lawyer. These licensed legal professionals provide legal advice and representation to clients in various areas, including criminal law, civil law, and commercial law. To become a Rechtsanwalt, individuals must complete a law degree and pass a rigorous examination. They are regulated by the German Bar Association and must adhere to strict ethical standards.

German lawyers are primarily governed by the codified law of the Federal Code for Lawyers, known as the Bundesrechtsanwaltsordnung (BRAO)³, and the Rules of Professional Practice. These regulations ensure that lawyers maintain high professional and ethical standards in their practice.

¹ Available at: [https://www.cvs.edu.in/upload/Scan%2024-Mar-2020%20\(1\).pdf](https://www.cvs.edu.in/upload/Scan%2024-Mar-2020%20(1).pdf)

² Cia, “Field Listing Legal System” 2

³ Bundesrechtsanwaltsordnung

Germany's Civil Law System

The German legal system is a codified legal system with roots in Roman-Germanic law. It comprises comprehensive statutes and legal codes, systematically assembling laws into collections. The most significant of these is the “Bürgerliches Gesetzbuch”⁴, enacted in 1900, which embodies the principles of Roman law within the context of German legal culture. This codification ensures legal clarity and predictability. Unlike common law systems, German law relies heavily on written rules rather than judicial precedent. It features a specialized court system and a hierarchical judiciary that interprets these codes precisely.

The “Bundesrechtsanwaltsordnung” (BRAO), or Federal Lawyers' Act, is a foundational legal framework regulating the profession of lawyers in Germany. This act provides detailed provisions on various aspects of legal practice, including specific guidelines for lawyers' accounting practices. These regulations are crucial in maintaining transparency and trust between lawyers and their clients, ensuring that lawyers manage clients' funds with utmost integrity and accuracy.

Key Provisions within the BRAO Concerning Lawyers' Accounting Practices:

1. Client Trust Accounts (§ 43a para. 7 BRAO)⁵

Attorneys and lawyers must keep money received from clients separate from their own funds. All such client funds must be deposited into special client trust accounts (escrow accounts). These accounts are designed to protect clients' money and ensure it is not commingled with the lawyer's personal or business funds.

2. Record Keeping (§ 50 BRAO)⁶

Lawyers are required to maintain orderly bookkeeping, which includes accurate documentation of all monetary transactions involving clients' money. Detailed records must be kept for a minimum of six years, starting from the end of the calendar year in which the case was concluded.

3. Professional Liability Insurance (§ 51 BRAO)⁷

Lawyers must have professional liability insurance to cover financial risks associated with the improper handling of clients' money.

4. Protection Measures

There are stringent penalties for the mismanagement or misappropriation of client funds. The BRAO provides mechanisms for disciplinary actions, ranging from fines to disbarment from practice.

As per Germany's Rules of Professional Practice, effective from January 1, 2011, Part 2, Section 1, General Professional and Fundamental Duties (§ 2 to 5), the management of clients' funds and assets by lawyers is meticulously regulated to ensure integrity and trust in the legal profession. According to these rules, lawyers must immediately pass any clients' money and other assets, such as securities or financial documents, to the rightful owners. Until this is feasible, these assets must be securely held in third-party accounts, typically

⁴ Bürgerliches Gesetzbuch

⁵ Bundesrechtsanwaltsordnung, § 50

⁶ Bundesrechtsanwaltsordnung, § 43a para. 7

⁷ Bundesrechtsanwaltsordnung, § 51

current accounts, with specific limits and duration stipulations. For instance, the balance in a collective client account for any party should not exceed 15,000 Euros and should not be held for longer than one month unless otherwise agreed in writing.

Furthermore, these rules strictly prohibit lawyers from using clients' funds, designated for other parties, to cover their legal fees. This measure ensures that clients' financial interests remain protected and prioritized. Lawyers are also required to promptly account for these funds upon completing their instructions.

Additionally, lawyers must operate their offices—whether central, satellite, or branch offices—in compliance with specified material, personnel, and organizational standards for professional practice. This includes ensuring that offices uphold stringent confidentiality and security protocols in handling sensitive client information and assets.

The regulations also emphasize ongoing professional education for lawyers. They are required to demonstrate knowledge of the regulatory framework governing their profession through regular attendance at training sessions covering organizational, general, and specific professional duties. This training aims to equip lawyers with the competence to handle legal and ethical complexities, particularly regarding accounting and the management of clients' funds.

These regulations establish a robust framework aimed at maintaining high standards of professionalism and ethics within Germany's legal profession, providing clients with confidence in the security and integrity of their assets under legal care.

Moreover, these regulations ensure that lawyers adhere to ethical standards when handling clients' money, regulated by local bar associations empowered to investigate and impose penalties for non-compliance under the BRAO.

The BRAO establishes mechanisms that ensure transparency and compliance in lawyers' financial dealings. Mandating the segregation of client and personal funds prevents commingling, thereby reducing the risk of fund misuse. Detailed bookkeeping requirements ensure that every transaction involving client funds is documented and traceable, facilitating precise and accessible auditing. Regular audits further strengthen the ability to detect irregularities early and ensure ongoing monitoring.

The threat of penalties, including potential disbarment, serves as a robust deterrent against unethical practices. These measures collectively foster a trustworthy environment essential for upholding the integrity of the German Bar.

India's Common Law System

India's common law system traces its origins to British rule, established during the British Empire's governance from the 18th to the 20th century. This legal framework is characterized by the doctrine of judicial precedence, where laws are developed through court decisions based on prior rulings. Indian common law integrates these principles with traditional Indian legal concepts. Post-independence, India retained and adapted the common law framework to its socio-legal context through statutes and codes tailored to accommodate the country's diverse cultural and societal dynamics.

In India, the accounting practices of advocates are primarily governed by the Advocates Act of 1961 and its accompanying rules established by the Bar Council of India. The Advocates Act sets standards for legal

education and professional conduct, outlining how advocates should manage their financial transactions to uphold integrity and transparency.

Key regulations include

Advocates in India are required to maintain meticulous records of all funds received from clients and other sources, such as the court, on behalf of their clients. This responsibility is detailed in rules 25 to 32 of Chapter 2, Part 6 of the Bar Council of India Rules 1975.⁸

According to Rule 25, advocates must maintain clear and comprehensive accounts of clients' funds under their management. These records should include detailed information about amounts received from clients, expenses paid on behalf of clients, fees charged for legal services, and all relevant dates and particulars.

Rule 26 of Chapter 2, Part 6 of the Bar Council of India Rules 1975 stipulates that upon receiving funds from a client, advocates must clearly record the purpose for which these funds are intended—whether for the advocate's fees or to cover expenses. It is crucial to note that funds designated for expenses cannot be utilized for advocate fees without explicit written consent from the client.

Rule 27 emphasizes that advocates must promptly notify clients whenever any amount is received on their behalf.

Rule 28 states that upon completion of a legal proceeding, an advocate may claim any agreed-upon fees from any unspent client funds they still hold.

Rule 29 addresses situations where fees have not been determined. In such cases, advocates are authorized to withdraw their lawful fees from remaining client funds after the case concludes. Any surplus funds must be promptly returned to the client.

Rule 30 mandates that advocates must provide clients with a copy of their account records upon request, with the client covering any associated copying charges.

Rule 31 prohibits advocates from entering into agreements that would convert client funds into personal loans. Finally, Rule 32 strictly forbids advocates from lending money to clients for the purpose of funding their legal cases.

In accountancy, formal statutes provide explicit, codified regulations that legally bind practices and require practitioners to adhere to specific norms and standards. These statutes ensure uniformity and predictability in financial reporting and compliance. Conversely, informal precedents consist of established practices, professional norms, and historical methods that guide behaviour through customary usage rather than legal mandate.

Formal statutes are enforceable by legal penalties for non-compliance, whereas informal precedents offer flexibility and adaptability in addressing unique situations based on collective experience. Together, formal statutes establish foundational requirements, while informal precedents provide practical interpretations and adaptations within the boundaries set by formal regulations.

⁸ Bar Council of India Rules 1975

This dual approach creates a comprehensive framework that combines regulatory rigor with practical guidance, ensuring both compliance and effective adaptation in the field of accountancy.

Conclusion

The differences in accountancy practices between Germany and India underscore the complexities and opportunities in aligning legal and accounting standards globally. These variations carry significant implications for multinational corporations, international legal practitioners, and global economic governance. They underscore the need for improved coordination and deeper understanding of diverse legal systems across borders.

While Germany's codified legal system emphasizes rigorous adherence to formal statutes, India's blend of common law with statutory regulations allows for more flexibility guided by informal precedents. These contrasting approaches not only reflect national legal traditions but also shape how financial practices are regulated and implemented.

In navigating these differences, fostering greater harmonization and mutual recognition of standards becomes crucial. This would facilitate smoother international transactions, enhance regulatory compliance across jurisdictions, and promote a more cohesive global economic framework. Ultimately, bridging these gaps in accountancy practices can contribute to more effective cross-border collaborations and sustainable economic development worldwide.
