

Key Issues Memorandum

Scottish Legal Aid Board

For the year ended 31 March 2012

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To the Accountable Office and Audit Committee of the Scottish Legal Aid Board (the Board), and the Auditor General for Scotland.

The purpose of this memorandum is to highlight the key issues affecting the results of the Board and the preparation of the Board's financial statements for the year ended 31 March 2012. It is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

We take responsibility for this memorandum, which has been prepared on the basis of the limitations set out in 'The small print'.

We would like to take this opportunity to record our appreciation for the kind assistance provided by the finance team and other staff during our audit.

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1 Executive summary

Financial Statements	
Audit Opinion	<ul style="list-style-type: none"> We intend to give an unqualified opinion on both the Statement of Accounts and on the regularity of transactions undertaken for the 2011-12 financial year.
Financial Statements	<ul style="list-style-type: none"> The draft financial statements and supporting working papers were of a very high standard, and as a result no audit adjustments were required.
Efficiency	<ul style="list-style-type: none"> The Board continues to deliver efficiencies in its operations. The administration budget fell by a further £1.1m in 2011-12.
Governance	
Annual Governance Statement	<ul style="list-style-type: none"> We reviewed the Board's first Annual Governance Statement and concluded that it meets the requirements of the SPFM and summarises the Board's well-developed governance arrangements. The Audit Committee operates in accordance with good practice and provides effective oversight.
Internal Audit	<ul style="list-style-type: none"> We have concluded that the work of Internal Audit was compliant with the government internal audit standards.
Risk Management	<ul style="list-style-type: none"> Risk management arrangements were found to be embedded across the Board and operating well.
Performance	
Targets and Standards	<ul style="list-style-type: none"> The Board has achieved each of its eight headline indicators for the year, despite increasing the standards set within 2011-12.
National Performance Reports	<ul style="list-style-type: none"> The Board has established procedures to obtain and review Audit Scotland National Reports in a timely manner and we found that they had responded positively to national reports and recommendations.
The Role of Boards	<ul style="list-style-type: none"> Arrangements are in place to ensure the Board operates as effectively as possible in line with good practice.

2 Key audit issues

In this section we present our findings in respect of matters and risks identified at the planning stage of the audit and we provide details of additional matters that arose during the course of our work.

2.1 Status of audit

Our audit is now substantively complete, and all matters arising were discussed with Finance Team on 28 June 2012. The audit of the Whole of Government Accounts pack is the only planned work outstanding at the time of reporting.

2.4 Matters identified at the planning stage

2.2 Matters identified at the planning stage

In the conduct of our audit, we have not had to alter or change our audit plan, which we communicated in our Audit Approach Memorandum presented to the Audit Committee on 6 February 2012. Our responses to the risks identified at the planning stage are detailed in the table at 2.4 below.

2.3 Matters identified in relation to related parties

As part of our work on the financial statements we conducted a review of the transactions occurring throughout the financial year. We found no matters arising in relation to the disclosure of related parties.

	Issue	Audit commentary
1	<p>Financial Position</p> <p>While legal aid expenditure is not cash limited, the Scottish Legal Aid Board's administration budget is cash limited. For 2011-12 this budget was reduced by £1.1m to £11.8m, a reduction of 8.5%. The Board calculate that this represents a reduction in real terms of 16% over 4 years, with further reductions planned for 2012-13, 2013-14 and 2014-15.</p> <p>External conditions including the challenging economic climate have resulted in higher levels of legal aid applications including historically high numbers of civil legal aid being applied for. Additionally, recent legislative changes and an extension of eligibility have contributed to an increase in demand for civil legal aid assistance.</p> <p>This demand led service increase coupled with a budgeted reduction in the Board's running costs presents an increasingly challenging operating environment.</p>	<p>This Board has engaged with the Scottish Government on two fronts: firstly to deliver significant efficiency savings in the way the Board is run, and secondly to identify areas for savings in the Legal Aid budget without damaging access to justice.</p> <p>During 2011-12, the Board's net administrative expenditure fell a further £0.7m on a cash basis. The Board has identified a range of savings measures including mandatory digitisation, procurement savings and staff reductions.</p> <p>In October 2011, the Scottish Government published <i>A Sustainable Future For Legal Aid</i> which identified a range of measures to identify further savings based on maximising the value of legal aid expenditure and ensuring that legal aid is focused on need.</p> <p>We also completed a review of the financial management and budgetary control system as part of our interim audit. This work included a review of savings plans incorporating the reductions in the administration budget, financial monitoring procedures and the processes for reporting the budget to the Board. Our review concluded that the financial management and budgetary control systems in place at the Board are well developed.</p>

	Issue	Audit Commentary
2	<p>Provision for Legal Aid Costs</p> <p>The Board makes a provision in the annual accounts to reflect legal aid costs that have been incurred in the financial year but not yet invoiced. The Board estimates the value of unbilled cases using established measurement techniques which are based on the latest data available.</p>	<p>We reviewed the process for calculating the year end provision during our interim audit visit by examining the methodology used to calculate the figure disclosed in the prior year accounts. It was found that while the total provision figure was correct, the detail underlying the movement in the provision per the provision note to the accounts was incorrect as a result of an error in a workings spreadsheet.</p> <p>The figure for the “amounts used in the period” was overstated, having equated these to the opening accrual figures rather than the actual payments made for each legal aid case. This also had the effect of understating the “unused amounts reversed in the period”. The opening and closing balances, as disclosed in the Statement of Financial Position, were correctly stated.</p> <p>As a result of this, the figures in Note 16 – Provisions for liabilities and charges in the 2010/11 accounts are incorrect by the following amounts:</p> <ul style="list-style-type: none"> • 'Amounts used in the period', (£32,748k), is overstated by £5,608k. • 'Unused amounts reversed in the period', £5,564k, is understated by £5,608k. <p>The Board has restated the relevant parts of the 2010-11 accounts in the notes to the 2011-12 Statement of Accounts. We reviewed the process undertaken to calculate the 2011-12 provision during our final audit work. There were no further matters arising as a result of this work.</p>
3	<p>Property Leases</p> <p>The Board has two leases in place for the property at Drumsheugh Gardens. The leases will expire in 2014-15 and 2015-16 and at the time of our audit planning, we noted that there was some uncertainty over future accommodation.</p>	<p>During the year the Board commissioned a dilapidation review but no significant developments have been made since the time of our audit planning. The requirement to move accommodation and any associated costs remain uncertain. For this reason, we agreed with management that no provision should be made for dilapidation costs, but the Board has disclosed the potential for future costs as a contingent liability within the Statement of Accounts.</p>

3 Financial Reporting

3.1 Legal Aid Fund Expenditure

The Fund's Legal Aid expenditure is demand led and subject to fluctuations. In recent years, the levels of applications for civil legal increased as a result of the impact of the recession, driving up gross civil legal assistance expenditure. However, increased income, arising from the contributions associated with the extension of eligibility; and an increase in recovered expenses, relating mainly to prisoners' "slopping-out" cases; drove the reduction in net expenditure from £55,166k in 2010-11 to £53,862k in 2011-12.

The table below highlights that most other categories of expenditure have fallen during the year. This reflects both an overall downward trend in applications, but also the results of the work undertaken by the Board to deliver substantial savings, including those arising from verification of the financial eligibility of applicants and reductions in average case costs arising from reductions in fees and travel.

There has also been a substantial decrease in 'other expenditure' as a result of the decrease in bad debts being written off, following a large increase in the provision in 2010-11 due to the impact of the recession.

Fund - Summary statement of comprehensive net expenditure	Actual 2012 £'000	Actual 2011 £'000
Civil Legal Assistance	53,862	55,166
Criminal Legal Assistance	97,197	108,499
Children's Legal Assistance	5,272	5,216
Other expenditure	776	1,561
Pension scheme finance costs	177	123
Net operating costs	157,284	170,565

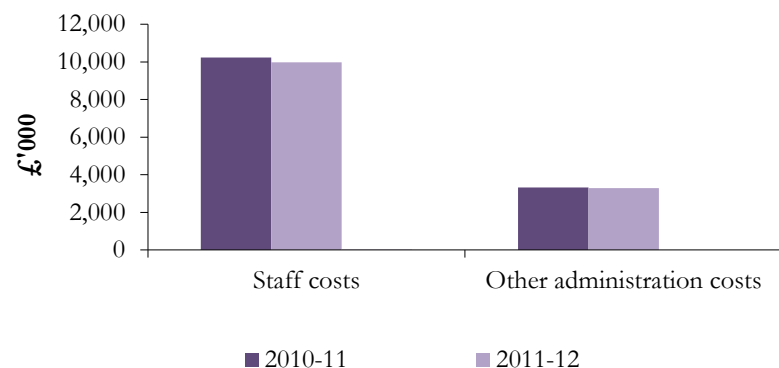
3.2 Legal Aid Board Expenditure

The Board's administrative functions record Net Operating Costs of £15,626k in 2011-12, slightly up from £15,548k in the prior year. The table below highlights that this was principally as a result of increased non-cash pension scheme interest costs.

Board - Summary statement of comprehensive net expenditure	Actual 2012 £'000	Actual 2011 £'000
Staff costs	9,977	10,232
Depreciation and amortisation	190	178
Loss on disposal of property, plant and equipment	10	0
Impairment of property, plant and equipment	11	0
Other administrative expenses	3,286	3,319
Income from shared services	(281)	(289)
Interest costs	2,433	2,108
Net operating costs	15,626	15,548

On an accruals basis, In the Board's Statement of Comprehensive net expenditure, most costs remained broadly in line with prior years. On a cash basis, the Board's administrative expenditure dropped by £0.7m, despite increases in functions as a result of recent legislation. Additional demands include a new grant funding scheme for in-court advisors, taking over responsibility for granting solemn criminal legal aid from the Scottish Courts Service, assuming the duty of advising Scottish Ministers on the availability and accessibility of legal services in Scotland and the introduction of a Quality Assurance scheme for criminal legal aid.

Despite the additional demands, as a result of steps previously taken by the Board to improve the efficiency of administering legal aid, such as digitisation, as the chart below highlights, staff costs fell by £255k in 2011-12. The whole time equivalent staff numbers fell by 14 during the year, from 300 to 286.



3.3 Financial position

Fund - Balance sheet	2011 £'000	2010 £'000
Non current assets	10,391	9,000
Current assets	10,865	9,446
Current liabilities	(60,825)	(60,763)
Non current liabilities	(28,719)	(25,817)
Total net liabilities	(68,288)	(68,134)
General fund	(68,288)	(68,134)
Total taxpayers' equity	(68,288)	(68,134)

The Legal Aid Fund has a negative balance sheet as a result of significant provisions for the value of unbilled live cases at the year end, and pension liabilities. We noted that non current assets have increased by £1,391k, principally due to a £1.1m increase in debtors over one year - relating to contributions due from assisted persons. This reflects the recent legislative changes whereby some applicants contribute more to their Legal Aid costs. The increase in current assets also stems principally from the increased contributions due from assisted persons which impact on the debtors due within one year.

The provision for amounts outstanding on already granted Legal Aid cases was in line with the prior year figures. Within current liabilities the provision stood at £52,471k (52,553k in 2010-11) and within non current liabilities the provision was £25,314k (£23,027 in 2010-11).

Board - Balance sheet	2011 £'000	2010 £'000
Non current assets	654	692
Current assets	855	1,028
Current liabilities	(255)	(246)
Non current liabilities	(46,965)	(42,134)
Total net assets	(45,711)	(40,660)
General fund	(45,711)	(40,660)
Total taxpayers' equity	(45,711)	(40,660)

The Board's liabilities have increased during the year by £4,831m due to a change in the staff pension liability, as reported by the actuary.

3.4 Conclusion

Overall the Scottish Legal Aid Board has managed its finances well. The Board's overall administration costs have been maintained despite increases in workloads across a number of areas. Removing depreciation, accruals and prepayments, in pure cash terms, expenditure has actually

decreased in the year. The Fund, which is not cash limited, has seen reduced expenditure overall.

4 Financial reporting matters

4.1 Commentary on key judgements and estimates

Going concern

As we note in Section 3, the balance sheets of both the Fund and the Board record significant net liabilities, of £68m and £46m, respectively.. The Board has based its assessment of going concern on the following factors:

- Grant-in-aid for 2012-13 has already been approved by Parliament and future parliamentary approval is anticipated to continue
- The grant-in-aid takes into account amounts necessary to meet the Board's liabilities falling due within the year, including pension liabilities
- The Board estimates the value of unbilled live cases each year to arrive at a provision. Although this creates a significant liability at the year end of £77.8m, the Legal Aid (Scotland) Act 1986 creates a statutory obligation for payment of sums due from the Legal Aid Fund.

The basis of the going concern assumption was found to be reasonable.

Revenue recognition

The predominant source of revenue for the Board is through government grant in aid. In line with the requirements of the FReM the grant in aid is accounted for on a cash basis.

4.2 Disclosure Omissions

We reviewed the Statement of Accounts to highlight areas where the disclosures did not meet the requirements of the FReM. No matters were arising in this review.

4.3 Review of principal accounting policies

We have reviewed the financial statements and present our view of the key accounting policies below, bringing to your attention in particular any significant judgements and estimates.

Accounting area	Summary of policy	Comment
Depreciation	<ul style="list-style-type: none"> • Depreciation is provided on all property, plant and equipment on a straight line basis, at rates calculated to write-off the re-valued cost, less estimated residual value, of each asset over its expected useful life 	<ul style="list-style-type: none"> • The Board has a relatively low value asset base. We concluded that the useful economic lives are reasonable and in line with sector expectations.

Accounting area	Summary of policy	Comment
Provisions	<ul style="list-style-type: none"> The liability to pay accounts resulting from work performed up to and including 31 March is calculated based on the number of outstanding legal aid certificates and estimates of cost and time since the certificate was issued. The amount of the provision falling due within twelve months is shown within current liabilities; the amount of the provision falling due in over twelve months is shown in non-current liabilities. 	<ul style="list-style-type: none"> The policy disclosed reflects the practices in place at the Board.
Pension Costs	<ul style="list-style-type: none"> The Legal Aid (Scotland) Pension Scheme 1988 is an unfunded pension scheme providing benefits based on final pensionable pay. The liabilities of the scheme are reported separately from those of the Board. Pension scheme liabilities are measured using a projected unit method and discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability. The amounts charged to the statement of comprehensive net expenditure represent both the service cost, i.e. the cost of the additional benefits earned as a result of employees' service in the current year; and the finance charge for the year arising from the interest on the scheme liabilities, in line with the requirements of International Accounting Standard 19 "Employee benefits". 	<ul style="list-style-type: none"> The scheme is administered on behalf of the Board by the Scottish Public Pensions Agency, an Executive Agency of Scottish Ministers. The disclosure is in line with the requirements of IAS .

5 Audit adjustments

5.1 Misstatements

We are required to communicate all uncorrected misstatements to you, other than those considered to be clearly trivial. There were no audit adjustments identified that we are required to bring to your attention.

6 Design effectiveness of internal controls

6.1 Accounting system and internal control

As part of our interim audit work we undertook reviews of the key financial systems including:

Payroll
General Ledger
Income and Debtors
Legal Aid Payments

There were no significant findings from our work on internal controls that we are required to report to the Audit Committee.

Our audit is not designed to identify all significant weaknesses in the Board's internal controls but is designed primarily for the purpose of expressing our opinion on the Board's Statement of Accounts. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.

In consequence, our work did not encompass a detailed review of all aspects of the internal controls and cannot be relied upon necessarily to disclose all defalcations or other irregularities or to include all possible improvements in internal control.

See '*The small print*' for further details of our approach in respect of internal controls.

7 Governance

7.1 Introduction

The Board and Accountable Officer are responsible for establishing arrangements for ensuring the proper conduct of its affairs, including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. The Audit Committee has a role in monitoring these arrangements. Our work on corporate governance focused on our review of the Board's arrangements to ensure there are effective systems in place for:

- the move to produce an Annual Governance Statement
- risk management arrangements
- arrangements for the prevention of fraud and corruption
- the provision of internal audit services

7.2 Annual Governance Statement

In 2011-12, the Scottish Public Finance Manual introduced a requirement to produce an Annual Governance Statement (AGS) within the Statement of Accounts for the first time. The AGS requires more disclosure than the previous Statement of Internal Control as it should reflect how the organisation conducts its business internally and in dealing with others.

The draft AGS was presented to Audit Committee on 14th May 2012 and describes the Board's well-developed arrangements for corporate governance and internal control, including the risk management processes, arrangements for internal audit and corporate planning framework. The Statement was informed by the Audit Committee's review of the Corporate Governance Framework in January 2012.

7.3 Risk management

The Board is due to review its approach to risk management in 2012. This review will be informed by the Justice Working Group's preparations for an overarching risk register for the Justice Ministerial portfolio.

We would be happy to support this review, but our initial assessment is that Board's approach to risk management is mature, and is embedded across the organisation. Updates to the risk register are reported to the Audit Committee on a quarterly basis, and the Board on an annual basis. There are clear links within the risk register to the Board's strategic objectives to ensure that board members have a sense of the risks to the body delivering the Corporate Plan.

7.4 Fraud and Corruption

One of the risks we identified within our Audit Approach Memorandum related to the financial and reputational risks that the organisation is exposed to from the submission of false or ineligible legal aid claims.

The Board has a duty to ensure that expenditure delivers Best Value within the terms of legislation. A significant part of the work of the Board is therefore to assess applications for legal aid, to ensure that legal aid is only granted in line with legislation. The Board applies the tests for civil legal aid, and for most criminal legal aid cases. We reviewed the targets and performance standards set for this process in Section 8 of this report.

The work of each investigation department is reported to the Audit Committee annually. The investigation work is undertaken based on risk, but pro-active exercises are also undertaken to provide additional assurance to the Chief Executive and the Board over each type of legal assistance.

In addition, the Accountable Officer requires that Internal Audit conduct an annual review of the Board's processes and programmes designed to mitigate and minimise fraud risk as part of our the annual internal audit activity plan. The overall objectives of the audit are to review and report on the internal controls governing the minimising of potential bad practice, abuse and fraud risk.

7.5 Internal audit

As this is the first year of our appointment, during our interim review we completed a detailed review of the Board's internal audit function against the good practice within the Government Internal Audit Standards.

Annual Audit Plans are approved by the Chief Executive and Audit Committee annually, and updates on progress are provided on a quarterly

basis. We found that the reports are clear, concise and constructive, and target timescales are set for their release and agreement.

All members of the internal audit team are independent of operational responsibilities and are required to undertake continuous professional development.

The department have a key role in supporting the Board's Annual Governance Statement, and provide an annual assurance report to the Chief Executive and Audit Committee to inform this work. We have therefore reviewed, and placed reliance on, their work in this area as part of our work on the Financial Statements.

8 Best Value and Performance

8.1 Introduction

All public bodies in Scotland have a duty to secure Best Value and continuous improvement. The Board's administration budget has significantly reduced over the last three years, representing a real terms reduction in resources of over 16%. The Board continues to work with the Scottish Government to identify further areas of efficiencies and savings.

8.2 Review of Performance

During 2011-12, the Board achieved each of its eight headline indicator targets (2010-11: achieved seven out of eight). The headline indicators monitor the individual timeliness and accuracy of each type of legal aid.

The Board continues to improve the service standards to ensure that applications are processed as quickly as possible, and the targets set therefore remain significantly challenging, particularly in light of financial constraints.

The Board has a Corporate Plan 2011-14, which is reviewed and approved annually. The Corporate Plan links to the National Performance Framework how the Board operates to support the five priority outcomes, and strategic objectives. The annual report describes the actions taken in 2011-12 to deliver against the outcomes. Performance is monitored by the Executive Team and Board throughout the year.

8.3 Delivering Best Value

The Board has delivered significant efficiencies in recent years. One of the approaches they adopt to identify scope for improvements and efficiencies is by subjecting parts of the organisation to a best value review. Recent reviews have included the costs associated with civil legal aid cases, legal aid in mental health cases, and immigration and asylum cases. A further best

value review into the granting of solemn criminal legal aid is planned later in 2012.

The best value reviews are supported by a wide range of research and benchmarking and we consider this internal scrutiny process to be good practice within central government.

Working with the Scottish Government and the Law Society of Scotland, the Board has developed a substantial programme to develop and implement changes and regulations designed to reduce legal aid expenditure in 2011-2012 and beyond, with a key objective of delivering best value by enabling savings to be made without damaging access to justice.

8.4 National reports

To maximise the impact of Audit Scotland's national performance audit work programme, we are required to follow up national reports affecting the Board in the year following publication.

Scotland's Public Finances

Audit Scotland published a national report, *Scotland's Public Finances – Addressing the Challenges* in August 2011, which considered how public bodies are responding to the challenge of a significant reduction in budget.

The report provides an overview of budgeting issues across the public sector. The matter was considered by the Audit Committee, who were content with the Board's view and approach to delivering a balanced budget for future years. The plans for "A Sustainable Future for Legal Aid" were reviewed by the Board in October 2011.

8.5 Role of Boards

In 2010, Audit Scotland published a national report on the governance arrangements for the range of public sector organisations.

The general points raised by the report include:

- Chief executives and their boards have parallel lines of accountability and this can cause confusion over who leads the organisation unless the separate roles are well defined and understood
- There are concerns about the recruitment of board members, including the falling number of applicants, the length of the recruitment process and the diversity of applicants

- The variety of methods that different Boards adopt to monitor and manage risk.

Our review of the Board's arrangements concluded that they are well developed and operate effectively. In May 2012, the Board approved a revised approach for assessing the effectiveness of the Board and its committees. Effectiveness tools have been developed using good practice materials, including the national report, to enable the committees and the Board to satisfy themselves that good practice is being followed. This review is due to be undertaken in July 2012.

9 The small print

Purpose of memorandum

This Key Issues Memorandum has been prepared for the benefit of discussions between Grant Thornton and the Scottish Legal Aid Board (the Board).

The purpose of this memorandum is to highlight the key issues affecting the Board's results and the preparation of the financial statements for the **year ended 31 March 2012**.

This document is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

We would point out that the matters dealt with in this report came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the Board's financial statements.

Responsibilities of the Board and auditors

The Board and Accountable Officer are responsible for the preparation of the financial statements and for making available to us all of the information and explanations we consider necessary. Therefore, it is essential that the Board and Accountable Officer confirm that our understanding of all the matters in this memorandum is appropriate, having regard to his knowledge of the particular circumstances.

Clarification of roles and responsibilities with respect to internal controls

The Chief Executive, as Accountable Officer, is responsible for the identification, assessment, management and monitoring of risk, for developing, operating and monitoring the system of internal control and for providing assurance he has done so.

In addition, the Accountable Officer is required to review all other internal controls and approve the statements included

in the annual report in relation to internal control and the management of risk.

The Audit Committee should receive reports from management as to the effectiveness of the systems they have established as well as the conclusions of any testing conducted by internal audit or ourselves.

We have applied our audit approach to document, evaluate and assess your internal controls over the financial reporting process in line with the requirements of auditing standards.

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.

In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

Independence and robustness

Ethical standards require us to give you full and fair disclosure of matters relating to our independence. We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

In accordance with best practice, we analyse the fees payable to Grant Thornton UK LLP and Audit Scotland for the external audit service below:

Audit Services	£
Audit	£43,500
Total audit fees	£43,500

ISAUK 260 requires communication of:

- relationships that have a bearing on the independence of the audit firm and the integrity and objectivity of the engagement team
- nature and scope of the audit work
- significant findings from the audit