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Scottish Legal Complaints Commission

Annual audit report to the Scottish Legal Complaints Commission and the Auditor General for Scotland

Year ended 30 June 2012

3 December 2012

Contents

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About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the *Code*").

This report is for the benefit of the Scottish Legal Complaints Commission and is made available to Audit Scotland (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

We also draw your attention to the following:

- management of the Scottish Legal Complaints Commission is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems;
- weaknesses or risks identified by us are only those which have come to our attention during our normal audit work in accordance with the Code, and may not be all that exist; and
- communication by us of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve the Scottish Legal Complaints Commission management from its responsibility to address the issues raised and to maintain an adequate system of control.

Executive summary

The Scottish Legal Complaints Commission ("the Commission") is a body independent of government, set up under the Legal Profession and Legal Aid (Scotland) Act 2007. The Commission's statutory functions include: dealing with complaints about legal practitioners; oversight of complaint handling by the legal profession; and monitoring the effectiveness of the Scottish Solicitor's Guarantee Fund and professional indemnity arrangements maintained by the relevant professional organisations.

The Commission receives no funding from government, its source of income being through a levy from the legal profession in Scotland, collected by the Law Society of Scotland. Its aim is to be independent, impartial and accessible.

The Commission accumulated significant cash balances and reserves in prior years and took the decision in 2011-12 to reduce the levy payable by legal practitioners, by funding around £1 million of the operating costs from reserves. The Commission aims to hold cash balances equivalent to three months operating costs and has broadly achieved this objective through the action in 2011-12.

In 2012-13 the levy is set at a higher level in order to achieve a balanced budget, albeit with a further £150,000 transferred from reserves.

In our first year as auditor, we considered opening balances as part of our audit. It was identified that a dilapidation provision should have been recognised in prior years, although since the amount is not material it has been recognised in the current year financial statements, rather than by adjusting prior year comparative amounts.

During 2011-12, in addition to the appointment of a new chief executive, the Scottish Government appointed four new members to replace seven members who had completed their term of office. In May 2012 internal audit performed a review of corporate governance and risk management, concluding that the controls over corporate governance and risk management arrangements were generally adequate and fit for purpose.

In terms of complaint handling activity, while the Commission noted that they resolved 36% more complaints than in 2010-11, the number of complaints received increased by 16%, contributing to an increased backlog.

The Commission has agreed three core priorities for the year ahead:

- reducing the level of backlogs and increasing the efficiency and effectiveness of the complaints handling processes;
- providing guidance and improving standards of client care and complaint handling within the legal profession; and
- engaging with the Scottish Government and other stakeholders to ensure that legislation is being implemented effectively and that areas for improvement are identified.

Management continues to ensure there is a system of internal control to ensure the regularity of income and expenditure, including arrangements to demonstrate Best Value.

We have completed our audit for 2011-12 and have issued an unqualified audit opinion on the financial statements and the regularity of transactions included within those financial statements.

Headlines

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("the *Code*"). This specifies a number of objectives for the audit.

We reported, in our audit strategy, our responsibilities in respect of the audit. The Commission's responsibilities are set out in appendix one.

This report summarises our work for the year ended 30 June 2012.

We wish to record our appreciation of the co-operation and assistance extended to us by Commission staff during the course of our work.

Financial statements	
Draft financial statements were provided on 13 September 2012, in line with the agreed timetable. These were broadly complete and of a high standard. Supporting information was received on the same date and the standard of requested analyses was high. Management responses to all queries were prompt, detailed and accurate and demonstrated a detailed understanding of the financial statements. From a review of post year end transactions and supporting schedules it was identified that two accruals and one other debtor were omitted or were incorrectly stated. These were adjusted in the financial statements. We have issued an unqualified audit opinion on the 2011-12 financial statements and the regularity of transactions reflected in those financial statements.	-
A number of technical accounting matters were considered during the audit process, including accounting for IT additions and lease dilapidation provisions.	Pages 5 and 6
Overall, we consider arrangements in the control environment associated with the compilation of the financial statements to be appropriate for the Commission. We have raised two management recommendations over good practice regarding independent review of reconciliations and reviewing post year end transactions in order to identify accruals at the year end.	Page 10
Use of resources	
The Commission budgeted a reduction in reserves of £993,000, achieved through the reduction of the levy payable by legal practitioners. The actual reduction in reserves was £755,000, lower due to a greater number of levies receivable and an operational contingency of £217,000 largely not being utilised. The 2012-13 budget forecasts a £152,000 deficit, incorporating a further restriction on levies in order to achieve a level of cash balances and reserves which the Commission considers is appropriate.	Page 7
Governance	
There have been no significant changes in the governance arrangements, other than the appointment of a new chief executive and the appointment by the Scottish Government of four new Commission members to replace seven members who had completed their term of office.	Page 10
Internal audit completed their planned audit work for the year and concluded that " *In our opinion SLCC has a framework of controls in place, in the areas which we have reviewed, that provides reasonable assurance regarding the effective and efficient achievement of the organisation's objectives and the management of key risks."*	Page 11

Headlines (continued)

Mandatory communications	
There are no unadjusted audit differences. We have presented adjusted audit differences in appendix three.	Appendix 3

Accounting policies; technical accounting matters

There have been no changes to accounting policies in 2011-12.

The financial reporting framework, as set out in HM Treasury's *Financial Reporting Manual* ("FReM") 2011-12, included a number of amendments. These have been correctly implemented in the management commentary and financial statements.

All other accounting policies have been applied consistently.

Accounting policies	There have been no changes to accounting policies in 2011-12. The accounting policies for the Commission remain appropriate.
Financial reporting framework ("FReM")	The Commission prepares financial statements having regard to HM Treasury's *Financial Reporting Manual* ("FReM"). The 2011-12 FReM has some new requirements, including: ▪ disclosure of median pay as part of the remuneration report; ▪ reference to the preparation of sustainability reports within the directors' report; and ▪ a governance statement, replacing the statement of internal control. We discussed the changes to the FReM with management and, following the audit process, these have been appropriately reflected in the management commentary and financial statements.
Accounting for expenditure on IT hardware and software	The Commission invested £176,000 in IT during the year, of which £86,000 related to the core hardware, servers and controllers. The balance of £90,000 is in relation to software which is separately identifiable and is disclosed as an intangible fixed asset. IT equipment is depreciated over three years and software is amortised over three years, in accordance with the Commission's accounting policy.

Accounting policies; technical accounting matters

We have considered opening balances and concluded that they are materially appropriately stated.

A dilapidation provision has been recognised in 2011-12 for the first time, in relation to the obligation to remove alterations at The Stamp Office at the end of the lease.

Opening balances	The accounting policies applied in 2011-12 are consistent with those applied in 2010-11. We have performed specific procedures in respect of material balances in 2010-11 and have not identified misstatements, save for the matter noted below. We identified that the lease agreement for the Stamp Office contains a 'yield up' clause which requires the Commission to remove all alterations and improvements to the property at the end of the lease. The lease was signed in 2008 at which time internal walls were constructed. No recognition of the 'yield up' clause obligation was made in the 2010-11, or previous financial years' financial statements. In accordance with IAS 16 *Property, plant and equipment* and IAS 37 *Provisions, contingent liabilities and contingent assets,* on completion of the enhancements a dilapidation provision should have been recognised at the net present value of the obligation. A corresponding increase to property, plant and equipment should have been recognised for the asset retirement obligation. This asset should then be depreciated to £nil over the period of the lease. Management consider that the obligation existed at the commencement of the lease and consequently have concluded that the financial statements as at 30 June 2011 contained an error. Since the net balance sheet impact and net income statement impact are not material, no adjustment has been applied to the prior year balances.
Accounting for dilapidation obligations	As noted above, the Commission concluded that a dilapidation provision is required in order to reflect the obligation to remove the alterations and improvements to the property at the end of the lease. The Commission's advisor in respect of lease negotiations has estimated that £10 per square foot is the likely obligation for the 'yield up' clause, being a £69,400 terminal value. In accordance with IAS 37 the provision is discounted to 30 June 2012, to reflect the fact that the obligation would not be settled until 2018. The obligation as at 30 June 2012 has been calculated as £43,700, applying an 8% discount factor. IAS 16 requires that an asset retirement obligation is recognised within property plant and equipment at the inception of the lease at the net present value of the dilapidation obligation, which would have been £34,700 if it had been recognised in 2008. The carrying value as at 30 June 2012 is therefore £20,800, after four years' depreciation. The dilapidation obligation and related asset retirement obligation have been recognised during the year ended 30 June 2012.

Financial position

The Commission laid before Parliament a budget for 2011-12 which assumed £933,000 transferred from reserves, in order to reduce the cash balances held by the Commission.

The actual reduction in reserves was £755,000, lower because of a greater number of practicing certificates and lower operating costs.

The 2012-13 budget assumes a further £152,000 is transferred from reserves, to enable a restriction in levies.

2011-12 financial outturn

The Commission started the year with a general fund of £1,757,000 and cash balances of £3,365,000. Cash as at 1 July 2011 included £1,517,000 of the 2011-12 levy which was paid in advance of the 2010-11 year end, giving a representative 'adjusted' balance of £1,848,000. The Commission has a target level of cash reserves of three months' expenditure and the decision was taken as part of the 2011-12 budgeting exercise to reduce the levy and underwrite £993,000 from reserves.

The 2011-12 budget assumed income of £1,837,000, including a total levy of £1,725,000. Expenditure of £2,830,000 was budgeted, incorporating a £217,000 contingency.

Total actual expenditure was broadly in line with budget, excluding the contingency. Staff costs of £1,631,000 were 15.2% greater than the prior year, arising from a 15.9% increase in headcount. The budgeted staff cost represented a 25.5% increase and the shortfall to budget is the result of the ideal level of staff being recruited slower than planned. Other administrative costs were consistent with 2010-11 although greater than budget, due to support costs for the new IT system and legal costs incurred in researching specific new Acts.

The deficit funded from reserves was £755,000, less than budgeted due to a greater number of practicing certificates and the unrequired contingency. The general fund as at 30 June 2012 was £1,002,000 and cash balances were £953,000.

2012-13 budget

The Commission has sought to develop a budget which enables it to deal effectively with a growing number of complaints as well as recognise the need for further efficiency savings and restricted increases in the levies payable by legal practitioners in Scotland.

	Actual 2010-11 £'000	Budget 2011-12 £'000	Actual 2011-12 £'000	Budget 2012-13 £'000
Operating income	**(2,232)**	**(1,837)**	**(1,909)**	**(2,661)**
Staff costs	1,415	1,776	1,631	1,809
Other administrative costs	989	803	1,011	828
Depreciation	4	34	3	26
Pension costs	(1)	-	(2)	-
Contingency	-	217	-	150
Net operating cost/(income)	**175**	**993**	**734**	**152**
Actuarial gain/(loss) on pension scheme	(8)	-	21	-
Net surplus/ (deficit)	**167**	**993**	**755**	**152**

A further £152,000 is budgeted to be transferred from the general fund, to underwrite the deficit for the year and reduce the level of reserves to the target three months. Growth in staff numbers is planned, in the development of the oversight function and to manage the greater level of complaints. The salient features of the budget are:

- the levy payable by legal practitioners operating in Scotland is increased on the prior year, to a level more aligned to the ongoing operating costs of the Commission;
- other administrative costs are budgeted to be lower than 2011-12 actual costs, primarily due to the one-off IT support costs incurred in that year; and
- a contingency of £150,000 is included, to allow for inflation and incorporate a £120,000 'legal expense buffer', considered necessary due to the unpredictability of some legal costs.

Best Value

We have considered arrangements to achieve Best Value and regularity of income and expenditure.

Audit area	Overview	Findings
Best Value	In April 2002 the Scottish Ministers introduced a non-statutory duty on accountable officers to ensure arrangements exist to secure Best Value. Audit Scotland has been committed to extending the Best Value audit regime across the whole public sector for some time now. Using the Scottish Executive's nine Best Value principles as a basis for audit activity, Audit Scotland previously selected five areas as priority development areas (use of resources, governance and risk management, accountability, review and option appraisal, and joint working). A series of toolkits covering financial, performance and governance processes are available for public sector organisations and auditor to use, but auditors were not required to complete specific toolkit(s) in 2011-12.	We reviewed some of the processes management has established to ensure Best Value is achieved throughout the organisation. The Commission operates a tight budget and costs are monitored to ensure value for money as well as compliance with policies. The most significant cost of the Commission is in respect of salaries and the SLCC has applied public sector pay policy in freezing pay for those earning in excess of £21,000. The largest item of expenditure during the year was in respect of the new IT system. In selecting the system a formal tender process was adopted and nine tenders were received. The selection criteria included value for money as well as service and capability requirements. We consider that the Commission has processes in respect of Best Value which are appropriate for the organisation. In terms of complaint handling activity, while the Commission noted that they resolved 36% more complaints than in 2010-11, the number of complaints received increased by 16%, contributing to an increased backlog. The Commission has agreed three core priorities for the year ahead: ▪ reducing the level of backlogs and increasing the efficiency and effectiveness of the complaints handling processes; ▪ providing guidance and improving standards of client care and complaint handling within the legal profession; and ▪ engaging with the Scottish Government and other stakeholders to ensure that legislation is being implemented effectively and areas for improvement are identified.

Regularity

Audit area	Overview	Findings
Regularity	As part of our audit of the Commission's financial statements, we are required by the Public Finance and Accountability (Scotland) Act 2000 to give an opinion on the regularity of expenditure and receipts shown in the financial statements.	As part of our work on the regularity of expenditure we reviewed the expenses policy applicable to all staff and tested a sample of expenses for reasonableness and authorisation in line with the Commission's procedures. Our sample testing did not identify any breaches of policy or inappropriate expenses. The expenses policy is generally consistent with good practice, particularly in respect of the requirement for the chief executive to review and authorise all personal expenses on a monthly basis prior to them being paid to the employee. We reviewed the allocation of receipts and expenditure to financial statement captions and did not identify any items inappropriately presented.

Corporate governance framework and supporting arrangements

Over-arching and supporting corporate governance have not changed significantly on the prior year and continue to provide a sound framework for organisational decision-making.

We have noted two recommendations to improve evidence of key financial controls and to identify post year end transactions requiring accrual.

Corporate governance and internal control arrangements **Standards of conduct and prevention and detection of corruption**	The Commission maintains an integrated governance framework to provide an appropriate structure for decision-marking, accountability, control and behaviour. The Commission has developed risk management arrangements based on guidance within the Scottish Public Finance Manual. During the year an internal audit review was performed in respect of corporate governance and risk management, the report concluded that "*overall, controls over corporate governance and risk management arrangements are generally adequate and fit for purpose".* During 2011-12, in addition to the appointment of a new chief executive, the Scottish Government appointed four new members to replace seven members who had completed their term of office. The finance function is small, reflecting the needs of the Commission, and this presents an increased inherent risk to absolute segregation of duties. It was identified that reconciliations performed by the finance and corporate services manager are not formally reviewed and signed as evidence of the review. Specifically, the monthly bank reconciliations are performed by the finance and corporate services manager with no further review to confirm that they have been appropriately performed. Journals are not reviewed and authorised prior to processing, giving rise to an increased risk of misstatements as a result of fraud or error. Notwithstanding the small finance function, we recommend that the bank reconciliation should be reviewed, challenged and authorised by someone other than the preparer. Journal policies and procedures should be documented and applied, ensuring that all journal entries have supporting documentation and are subject to independent review and authorisation. ***Recommendation one***
Governance statement	The governance statement provides detail of the governance framework, the system of internal control, internal audit, internal financial controls and risk management arrangements, and analyses the effectiveness of these elements of the framework. It describes a number of sources of assurance for the accountable officer. We reviewed the governance statement to confirm that it is in line with new guidance and reflects our understanding of the Commission.
Year end procedures	During the audit it was noted that two accruals and one other debtor were not appropriately stated: ▪ £23,500 invoice relating to 2011-12, received in July 2012 and not accrued as at 30 June 2012; ▪ £14,821 understated holiday pay accrual; and ▪ £2,256 understated interest receivable debtor. The entries have been processed by management and are shown on the schedule of adjusted audit differences. A structured procedure for each period-end is recommended in order to identify items which require recognition, including a review of post year end invoices. ***Recommendation two***

Corporate governance framework and supporting arrangements (continued)

The work of internal audit has been considered as part of our audit.

Internal audit	As set out in our audit plan and strategy, we reviewed the work of internal audit in 2011-12. The audit plan is relatively large for an organisation of the SLCC's size, we understand that this is to support the Commission as it develops. During the year internal audit submitted the following reports to the Commission: ▪ core financial systems; ▪ FOI and data protection; ▪ business continuity planning; ▪ ICT network infrastructure; ▪ corporate governance and risk management; and ▪ follow up of the status of previous recommendations. Internal audit completed their planned audit work for the year and concluded that " *In our opinion SLCC has a framework of controls in place, in the areas which we have reviewed, that provides reasonable assurance regarding the effective and efficient achievement of the organisation's objectives and the management of key risks".* Due to the areas of focus of internal audit in the year, we did not place specific reliance on any the reports issued, but they assisted our understanding of the Commission's operations and overall systems of internal control and governance framework.
Prevention and detection of fraud	The Commission has procedures and controls to reduce the risk of fraud. Expenses are reviewed and authorised by the chief executive prior to payment. An employee handbook and code of conduct are in place to document the requirements of staff in conducting their roles. In 2011-12 no significant or other fraud or irregularity was identified by management, internal audit, or through the course of our external audit work.
Related party transactions	We considered the procedures in place to identify related party transactions and discussed with management the existence of any such transactions. No related party transactions were identified.

Appendices

Audit Scotland code of audit practice – responsibilities of the Commission

Financial statements

Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources. Audited bodies are responsible for:

- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority;
- maintaining proper accounting records;
- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the relevant financial reporting framework (eg, the Financial Reporting Manual or an Accounting Code of Practice);
- preparing and publishing with their financial statements an annual governance statement, statement on internal control or statement on internal financial control and a remuneration report; and
- preparing consolidation packs and, in larger bodies, preparing a Whole of Government Accounts return.

Systems of internal control

Audited bodies are responsible for developing and implementing systems of internal control, including risk management, financial, operational and compliance controls. They are required to conduct annual reviews of the effectiveness of their governance, systems of internal control, or internal financial control, and report publicly that they have done so. Such reviews should take account of the work of internal audit and be carried out by those charged with governance, usually through bodies' audit committees.

Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions;
- developing and implementing strategies to prevent and detect fraud and other irregularity;
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity; and
- participating, when required, in data matching exercises carried out by Audit Scotland.

Standards of conduct and arrangements for the prevention and detection of bribery and corruption

Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and should put proper arrangements in place for:

- implementing and monitoring compliance with appropriate guidance on standards of conduct and codes of conduct for members and officers;
- promoting appropriate values and standards; and
- developing, promoting and monitoring compliance with standing orders and financial instructions.

Audit Scotland code of audit practice – responsibilities of the Commission (continued)

Financial position

Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- such financial monitoring and reporting arrangements as may be specified;
- compliance with any statutory financial requirements and achievement of financial targets;
- balances and reserves, including strategies about levels and future use; and
- the impact of planned future policies and foreseeable developments on their financial position.

Best Value

Achievement of Best Value or value for money depends on the existence of sound management arrangements for services, including procedures for planning, appraisal, authorisation and control, accountability and evaluation of the use of resources. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.

Management representations

You are required to provide us with representations on specific matters such as your financial standing, application of accounting policies, and whether the transactions within the financial statements are legal and unaffected by fraud.

In the representation letter, we requested your specific confirmation that:

a) all significant retirement benefits, including any arrangements that are:

- statutory, contractual or implicit in the employer's actions;
- arise in the UK and the Republic of Ireland or overseas;
- funded or unfunded; and
- approved or unapproved,

have been identified and properly accounted for.

Audit differences

Three adjusted audit differences were identified during the audit process; they have a total impact of £58,000 on the deficit for the year.

Adjusted caption	Dr £000	Cr £000
Staff costs	15	
Accruals		15
Legal costs	23	
Accruals		23
Other debtors	2	
Interest receivable		2
Tangible fixed assets	22	
Operating costs	22	
Dilapidation provision		44

Unadjusted caption	Dr £000	Cr £000
-	-	
-		-

Other presentational amendments were made to the disclosures in respect of the IT investment, accounting policies and the governance statement.

Action plan for management recommendations

Priority rating for recommendations		
Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the Commission or systems under consideration. The weaknesses may therefore give rise to loss or error.	**Grade two** (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.	**Grade three** (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
1 Segregation of duties – independent review		**Material**
The finance function is small and it was identified that reconciliations performed by the finance and corporate services manager are not subject to independent review. Specifically, the bank reconciliation is not reviewed by someone other than the preparer. Journal policies and procedures are not formalised and journals are not always subject to independent review and authorisation prior to processing.	Completing the bank reconciliation on a monthly basis is a key control over the accuracy of financial statement captions and helps detect fraud or error. Notwithstanding the small finance function, the bank reconciliation should be reviewed, challenged and authorised by someone other than the preparer. Journal policies and procedures should be documented and applied, ensuring that all journal entries have supporting documentation and are subject to independent review and authorisation.	Agreed that the Finance Officer will complete bank reconciliations for review and authorisation by Finance & Corporate Services Manager. The Financial Procedures will be updated to reflect this, and the procedure for completion and authorisation of journal entries which has been in place since July 2012. **Responsible officer:** Finance & Corporate Services Manager **Implementation date:** 31 October 2012

Action plan for management recommendations (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
2 Post year end transactions review		**Low**
It was identified from a review of July invoices and July bank statements that three items should have been recognised in the year to 30 June 2012, although these were not identified by management.	At the period end management should review invoices and bank statements received subsequent to the period end, in order to consider if transactions should be recognised during the period.	Agreed. This will be built into quarterly management accounts procedures to ensure transactions are correctly recognised. **Responsible officer:** Finance & Corporate Services Manager **Implementation date:** 31 October 2012

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