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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 2013

17 October 2013

Contents

The contacts at KPMG in connection with this report are:

Stephen Reid
Director, KPMG LLP

Tel: 0131 527 6795
Fax: 0131 527 6666
stephen.reid@kpmg.co.uk

Andy Shaw
Director, KPMG LLP

Tel: 0131 527 6673
Fax: 0131 527 6666
andrew.shaw@kpmg.co.uk

Amanda Williams
Audit In-charge, KPMG LLP

Tel: 0191 401 3925
Fax: 0191 401 3751
amanda.williams@kpmg.co.uk

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 ("the 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.

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 overview our responsibilities in respect of the audit. The Commission's responsibilities were set out in appendix one.

This report summarises our work for the year ended 30 June 2013.

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

Area	Summary observations	Analysis
Service overview		
Business issues and financial position	The Commission is implementing a strategy to improve the efficiency of the complaints handling process, through the restructuring of the enlarged support team. Total expenditure in 2012-13 was budgeted at £2.786 million compared to £2.645 million in 2011-12. Income was forecast to increase by £0.752 million to £2.661 million, resulting in a budgeted deficit of £0.125 million. The actual 2012-13 deficit was £0.234 million, as a result of higher than budgeted expenditure. The cash balance as at 30 June 2013 was £0.827 million and the general fund was £0.778 million.	Page 5
Performance management		
Performance management	We consider that there is a robust budget setting process and monthly review of the financial results. Accurate forecasting of legal expenses is inherently difficult and management has invested in an in-house lawyer in order to reduce such costs. The operational plan has a focus on reducing non-staff costs by 15% by 30 June 2014	Page 8
Governance and narrative reporting		
Governance	Our review of governance arrangements did not identify any issues and we consider the arrangements to be appropriate for the size and operations of the Commission. We note that improvements are required to the financial statements preparation process, this will also allow enhanced scrutiny arrangements by the audit committee, prior to final approval by the board.	Page 11
Control observations	Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls relating to financial systems and procedures are designed appropriately and operating effectively. Control observations identified within our 2011-12 audit report were addressed during the year.	Page 11

Headlines (continued)

Area	Summary observations	Analysis
Financial statements and accounting		
Accounting policies	There have been no changes to accounting policies in 2012-13. No newly effective accounting standards are expected to have a material impact on next year's financial statements.	Page 14
Audit conclusions	We have issued an unqualified audit opinion on the 2012-13 financial statements.	Page 15
Year-end process	The draft financial statements and remuneration report were received by the agreed date and were supported by good quality working papers. The governance statement and full management commentary were received on 10 September 2013. The financial statement approval and audit timetable was shorter than in 2011-12 and as a result the fully completed financial statements were not available at the start of our onsite audit fieldwork. There were a few presentational corrections and an adjustment in respect of pensions accounting that were processed by management during our audit.	Page 15

Service overview

Our perspective on key business issues and the financial position of the Commission

Key business issues and financial position

The Commission is operating deficit budgets, drawing on cash generated in prior years. The 2013-14 deficit is budgeted to be lower than in 2012-13.

Background

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.

Income and expenditure summary

	Actual 2011-12 £'000	Budget 2012-13 £'000	Actual 2012-13 £'000	Budget 2013-14 £'000
Operating income	(1,909)	(2,661)	(2,720)	(2,709)
Staff costs	1,630	1,809	1,886	2,184
Other administrative costs	1,006	828	1,072	699
Pension interest costs	(2)	-	-	-
Contingency	-	150	-	-
Net operating cost	**734**	**125**	**238**	**204**
Actuarial loss/(gain) on pension scheme	21	-	(14)	-
Net deficit	**755**	**125**	**224**	**204**

Source: KPMG analysis of management schedules

Financial position

Budgeted income for 2012-13 was £2.661 million, with expenditure of £2.786 million. The increase in income from 2011-12 was expected as the general levy was limited in 2011-12 and there were a greater number of practitioners in 2012-13.

Actual income was £2.720 million, the £0.059 million surplus to budget reflecting a higher number of complaints levies and greater interest receivable.

Actual expenditure in 2012-13 was £0.172 million greater than budget at £2.958 million, including the contingency of £0.150 million. The key variances were:

- staff costs were £0.077 million greater than budget, primarily due to outsourced and agency staff costs incurred pending permanent staff recruitment;
- legal costs of £0.268 million incurred compared to a budget of £0.197 million, reflecting the required advice to support cases. The reduction of legal costs is a focus for the Commission, as it continues on it strategy of improving operational efficiencies. The recruitment of an in-house lawyer and the development of a case database is anticipated to reduce legal costs in future years; and
- IT costs of £0.115 million, relating to the Workpro development and support costs, compared to a budget of £0.053 million.

The net deficit of £0.224 million, after an actuarial gain of £0.014 million results in a general reserve as at 30 June 2013 of £0.778 million, with a cash balance of £0.827 million. This represents around three and a half month's budgeted expenditure; the Commission's policy is to hold cash reserves of three months.

The Commission is considering the appropriate level of reserves to hold, with a view of reducing the three month level.

Key business issues and financial position

2013-14 budget

The 2013-14 budget reflects a time where the Commission is developing its strategy of managing complaints. The budget is intended to enable the Commission 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.

The 2013-14 budget incorporates a 16% increase in staff costs from 2012-13 actual results, being a £0.302 million increase. This reflects an expected increase in FTEs from 37 in 2012-13 to 42 in 2013-14.

Total expenditure is budgeted to be broadly consistent with the prior year, at £2.913 million (2012-13: £2.954 million). Administrative savings are anticipated to be achieved, through a focus on tighter budgetary control, lower property costs and reduced legal costs. The primary driver of the decrease is the greater use of the in-house lawyer.

Levy income is restricted for 2013-14, being broadly consistent with 2012-13 at £2.684 million, with total budgeted income of £2.709 million. The budget therefore incorporates a further underwriting of the Commission's expenditure from reserves, with a budgeted transfer from general reserve of £0.204 million.

Complaints handling

The Commission closed 34% more complaints in 2012-13 compared to 2011-12. This performance follows a restructuring exercise, where the Gateway and Investigations teams were merged, an Oversight team was formed and more resource was recruited to deal with enquiries. Complaints in hand as at 30 June 2013 were 627, being a 20% decrease on 30 June 2012 compared to a 11% reduction in complaints received.

Property lease

The lease agreement for the Stamp Office included a lease break option, which could be exercised in January 2013. Management agreed heads of terms with the landlord for a reduced rent and initial rent free period in respect of the lease, with a view of exercising the option. Through an alleged error by the Commission's adviser, the terms of break notice were not correct and the option was not effectively exercised.

The Commission is consequently obligated to a higher rent than was negotiated and a claim has been made against the adviser, to recover the excess rent and related legal fees. The adviser is cooperating with the proceedings, although has not formally accepted liability. The reduced rent was applicable from 8 September 2013 and management has incorporated the reduction in the 2013-14 budget, in anticipation of a full settlement or ruling in the Commission's favour.

The total claim for the five years remaining on the lease is around £0.25 million and no recognition has been made in the financial statements as at 30 June 2013. We consider this to be appropriate as the receipt is not certain and it also relates to costs to be incurred in 2013-14.

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Performance management

Our perspective on the performance management arrangements, including follow up work on Audit Scotland reports

Performance management

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

Best Value	Accountable officers have a non-statutory duty to ensure there are arrangements designed to secure Best Value. Audit Scotland is committed to extending the Best Value audit regime across the whole public sector. 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). We reviewed some of the processes management has established to ensure Best Value is achieved throughout the organisation. This includes: ▪ robust budget setting procedures and monthly review of expenditure against budget; ▪ review and authorisation of employee expenses on a monthly basis by the chief executive; ▪ review and authorisation of payroll exception report on a monthly basis by the chief executive; and ▪ formal tender process required for large items of expenditure in line with Scottish Government procurement requirements, although there has been no significant new expenditure projects in the year, with the Workpro tender being undertaken in 2011-12. The most significant cost of the Commission is in respect of salaries and the Commission previously applied public sector pay policy in freezing pay for those earning in excess of £21,000. 1% pay rises were applied as of January 2013, following approval from the Scottish Government Remuneration Group. We consider that the Commission has processes in respect of Best Value which are appropriate for the organisation.
Regularity	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 expenses on a monthly basis prior to them being paid to employees. We reviewed the allocation of receipts and expenditure to financial statement captions and did not identify any items inappropriately presented. Internal audit performed a review of systems during 2012-13 and concluded that there were no major weaknesses, however, some areas for improvement were identified, relating to segregation of duties, effective authorisation of members' expenses and timeliness of bank reconciliations.

Performance management

Management has considered progress against the Director General, Governance and Communities' letter regarding corporate expectations.

Corporate expectations	The Scottish Government's Director General, Governance and Communities wrote to public bodies on corporate expectations in July 2012 asking for a preliminary assessment of progress towards these expectations. Management has formally considered progress against the expectations and , while the nature of the Commission means that the letter is not fully relevant, management consider that the actions of the Commission are in line with the corporate expectations objectives. The Commission is proactively reducing operating costs, engaging with Scottish Government on an ongoing basis and supports the employment objectives of the Scottish Government.
Scotland's public finances: addressing the challenges	As part of its targeted approach to following-up a small number of performance audit reports each year, Audit Scotland identified the *Scotland's public finances: Addressing the challenges* for follow-up by local auditors in 2012-13. The aim of the follow-up work is to assess how public bodies are responding to the challenges of public sector budget constraints and their efforts to achieve financial stability. The targeted follow up does not apply to the Commission, and we will not be reporting separately to Audit Scotland. We note that the Commission's strategy is focused on improving the efficiency and effectiveness of the complaints handling process and the levies have been set at a level where the Commission contributes to expenditure from reserves. The Commission has robust budgeting procedures, although did not operate within budget in 2012-13, the investment in the complaints handling team and the recruitment of an in-house lawyer is expected to reduce the volatility of legal costs.

Governance and narrative reporting

Our overall perspective on your narrative reporting, including the remuneration report and annual governance statement

Update on controls findings from our audit

Corporate governance arrangements

We updated our understanding of the governance framework and did not identify any issues in relation to governance.

Annual governance statement and governance arrangements	The governance statement for 2012-13 outlines the corporate governance and risk management arrangements in operation in the financial year. It summarises the governance framework, the system of internal control, internal audit, internal financial controls and risk management arrangements and confirms the effectiveness of these elements of the framework. It describes a number of sources of assurance for the accountable officer. We have updated our understanding of the governance framework and documented this through our overall assessment of the Commission's risk and control environment. This work has formed part of our assessment of the Commission's annual governance statement. We consider the governance framework and annual governance statement to be appropriate for the Commission. We note that the financial statements approval timetable was shorter than in prior years and the financial statements were not available in advance of the scheduled audit committee meeting. The provision of finalised financial statements in advance of the audit committee meeting facilitates enhanced scrutiny arrangements by the audit committee prior to approval by the board. From 1 January 2013 a new chairing member of the Commission was appointed, following the end of the term of office of the previous chairing member. The board consists of nine members, three of whom have legal backgrounds.
Annual report, including the management commentary	The financial statements form part of the annual report of the Commission for the year ended 30 June 2013. We are required to consider the management commentary and provide our opinion on the consistency of it with the financial statements. We are satisfied that the information contained within the management commentary is consistent with the financial statements. Changes to the UK Corporate Governance Code, which will be applicable for year ending 30 June 2014, will require that the 'front end' narrative reporting is 'fair, balanced and understandable.' Audit committees will be expected to consider this as part of their consideration of the annual report and financial statements. In our view, the annual report already complies broadly with this requirement, although we recommend early consideration of the requirements of the revised UK Corporate Governance Code against the Commission's reporting format.
Internal controls	We have identified no control weaknesses during our work and note that management has implemented the recommendations made in the prior year, in respect of independent bank reconciliation and journal review. The finance function is small, reflecting the needs of the Commission, and this presents an increased inherent risk over segregation of duties.

Corporate governance arrangements (continued)

Remuneration report	The remuneration report and pension figures were provided in advance of the commencement of the audit, and supported by good quality information to support the disclosures provided. Disclosures are in line with the requirements of the *Note for guidance 2013/3* issued by Audit Scotland.
Internal audit	We reviewed the work of internal audit in 2012-13 to inform our assessment of risks that need to be considered and addressed during the audit. The content of the internal audit plan is, in our view, appropriate for the size and nature of the Commission. During the year internal audit submitted the following reports: ▪ core financial systems (income and receivables, payroll and expenses, cash and treasury measurement); ▪ customer responsiveness; ▪ stakeholder engagement; and ▪ ICT healthcheck. 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".* We did not place specific reliance on any the reports issued in the year; reports supported our understanding of the Commission's operations and assessment of overall systems of internal control.
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 2012-13 no significant or other fraud or irregularity was identified by management, internal audit, or through the course of our external audit work.

Financial statements and accounting

Our perspective on the preparation of the financial statements and key accounting judgements made by management

Accounting policies and going concern

There have been no changes to accounting policies in 2012-13. All accounting policies have been applied consistently.

There have been no substantive changes to the financial reporting framework as set out in the Government's *Financial Reporting Manual* ("FReM").

The financial statements have been prepared on a going concern basis

Accounting framework and application of accounting policies	
Area	**KPMG comment**
Financial reporting framework	■ The Commission prepared the financial statements in accordance with the Government Financial Reporting Manual 2012-13 ("FReM"). ■ During the year there have been no substantive changes in financial reporting requirements, and consequently there are no material changes to the Commission's accounting policies. ■ We are satisfied that the accounting policies adopted remain appropriate to the Commission.
Impact of revised accounting standards	■ Disclosure has been included in the financial statements highlighting that the impact of revisions to IAS 19 `*Employee benefits*' if the standard had been adopted early in 2012-13 would not have been material, with the estimated change to finance costs being around £1,000. ■ No other newly effective accounting standards are considered to have a material impact on the Commission's financial statements.
Going concern	■ The financial statements have been prepared under the assumption that the organisation is a going concern. Given the nature of the Commission's activities and the historical agreement of levies with the Law Society of Scotland, which are broadly in line with budget, this is a reasonable assumption . The budget for 2013-14 is broadly balanced and the Commission holds cash of over £0.7 million.

Audit conclusions

We have issued an unqualified audit opinion on the financial statements and the regularity of transactions reflected in those financial statements.

The financial statements were made available on a timely basis and were accompanied by high quality working papers.

Audit conclusions

Following approval of the financial statements by the board, we issued an unqualified opinion on the truth and fairness of the state of the Commission's affairs as at 30 June 2013, and of the Commission's deficit for the year then ended. We also provide our unqualified opinion on the regularity of transactions within the year. There were no matters identified on which we are required to report by exception.

In gathering the evidence for our opinion we have:

- performed a mixture of substantive and controls testing to ensure an efficient approach that covers all the key risks;
- liaised with internal audit and reviewed their reports to ensure all key risk areas having a potential financial statements impact have been considered;
- reviewed assumptions and judgements made by management and considered these for appropriateness;
- considered if the financial statements may be affected by fraud through discussions with senior management and internal audit to gain a better understanding of their work in relation to prevention and detection of fraud with the potential to impact on the financial statements; and
- attended the audit committee to communicate our findings to those charged with governance, but also to update our understanding of the key governance processes and obtain key stakeholder insights.

Financial statements preparation

Preparation of the financial statements

- Draft financial statements and good quality working papers were provided at the start of the audit fieldwork in June 2013. This included the management commentary and the remuneration report, although not the chairman's foreword, the business review or the governance statement. The financial statements approval timetable was shorter than in 2011-12, at the request of the audit committee. While the core financial statements were available for audit as agreed, the full financial statements were not available until September 2013.
- In advance of our audit fieldwork, we issued a 'prepared by client' request setting out a list of required analyses and supporting documentation. The standard of documentation was good.
- Throughout the course of the year we have had regular correspondence with the finance team to ensure that disclosure within the financial statements was consistent with the requirements of the FReM. We identified presentational adjustments in respect of the bad debt provision and an immaterially misstated pensions actuarial gain. These were subsequently adjusted by management.
- There are no significant matters in respect of (i) audit differences; (ii) auditor independence and non-audit fees; and (iii) management representation letter content.

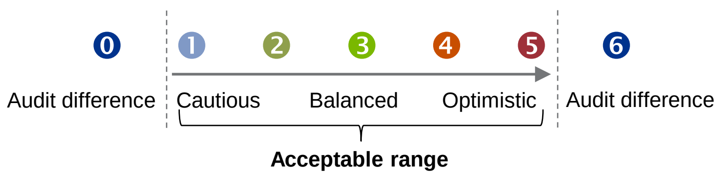
Overview assessment

Overall, in respect of the key judgements made in the preparation of the financial statements, we are satisfied that management's judgements are generally balanced, and do not represent either an overly optimistic, or overly cautious, position.

Assessment of subjective areas

Asset/liability class	Current year	Prior year	Balance (£'000)	KPMG comment
Lease dilapidations	3	3	(47)	During 2011-12 management recognised a provision in respect of lease dilapidations, as required by IAS37 *Provisions, contingent liabilities and contingent assets*. The provision for the likely obligation for the 'yield up' clause was based on £10 per square foot , being a £69,400 terminal value, discounted by applying an 8% discount factor as at 30 June 2012 to give a £44,000 provision. The lease break clause was not exercised during 2012-13 and the lease is expected to run its full course. There have been no matters during the year which indicate that £10 per square foot is no longer appropriate and management has unwound the discount by one year to give a provision as at 30 June 2013 of £47,000. We concur with this approach.
Bad debt provision	2	3	(35)	Management has recognised a bad debt provision of £34,871 against gross debtors of £40,372. The provision relates to 24 legal firms whose debts are over three months old where recovery is considered doubtful. Management is actively pursuing recovery of all debts. Subsequent to the year end only £579 had been recovered in respect of the provided debts, supporting the need for a provision. We consider the provision to be prudent however, reflecting 100% of the balances over three months old, which assumes that no balances will be recovered. The provision is inherently judgemental and, in light of the low level of recovery, we are content with management's provision.

Level of prudence



Cautious means a smaller asset or bigger liability; Optimistic is the reverse

Appendices

Mandatory communications

There were no unadjusted differences to the core financial statements. There was one adjusted audit difference.

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	There were no audit adjustments required to the draft financial statements which impacted on the net assets or the net expenditure for the year. The actuarial gain in respect of the pension scheme was originally understated by £4,000, with a corresponding overstatement in staff costs, and this was subsequently adjusted. A small number of minor presentational adjustments were required to some of the financial statements notes.	-
Unadjusted audit differences Audit differences identified that we do not consider material to our audit opinion	We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you. There are no unadjusted audit differences.	-
Confirmation of Independence Letter issued by KPMG to the Audit Committee	We have considered and confirmed our independence as auditors and our quality procedures, together with the objectivity of our Audit Director and audit staff.	Appendix one
Schedule of Fees Fees charged by KPMG for audit and non-audit services	No non-audit services were provided in 2012-13.	-
Draft management representation letter Proposed draft of letter to be issued by the Commission to KPMG prior to audit sign-off	There are no significant changes to the standard representations required for our audit from last year.	-

Auditor independence and non-audit fees

Auditing Standards require us to consider and confirm formally our independence and related matters in our dealings with the Commission.

We have appropriate procedures and safeguards in place to enable us to make the formal confirmation in our letter included opposite.

Auditor independence

Professional ethical standards require us to provide to you at the conclusion of an audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed. This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence.

We have considered the fees paid to us by the Commission for professional services provided by us during the reporting period. We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Regular communications
- Internal accountability
- Risk management
- Independent reviews

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the Commission or the chief executive.

Confirmation of audit independence

We confirm that as of 30 September 2013, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of the Audit Committee and should not be used for any other purpose.

Yours faithfully

KPMG LLP

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