KPMG

cutting through complexity

Scottish Legal Complaints Commission

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

Year ended 30 June 2014

13 October 2014

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 Scottish Legal Complaints Commission and is made available to Audit Scotland and the Auditor General for Scotland (together "the Beneficiaries"). This report has not been designed to be of benefit to anyone except the Beneficiaries. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Beneficiaries, even though we may have been aware that others might read this report. We have prepared this report for the benefit of the Beneficiaries alone.

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.

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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.

In accordance with ISA (UK and Ireland) 260: *Communication with those charged with governance,* this report also summarises our work in relation to the financial statements for the year ended year ended 30 June 2014.

We wish to record our appreciation of the 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 has seen the benefit of operational enhancements, designed to improve the efficiency of the complaints handling process; with greater productivity and lower related expenditure. In 2013-14 the Commission focussed on early resolution and a greater number of cases were closed without the need for formal determination. The focus for 2014-15 is to continue the development of case handling in order to minimise appeals. Total expenditure in 2013-14 of £2.757 million compares to the budget of £2.913 million and prior year of £2.958 million. The net operating cost, prior to actuarial movements in respect of the pension scheme, was break even; with income of £2.757 million against the budget of £2.709 million. Reserves as at 30 June 2014 of £0.737 million represent over three month's budgeted expenditure, the cash balance at the year end was £1.056 million.	Page 6
Financial reporting and accounting		
Audit conclusions	We have issued an unqualified audit opinion on the 2013-14 financial statements, following their approval by the accountable officer.	Page 9
Significant risks and audit focus areas	We have considered inherent significant risks that the ISAs would require us to raise covering risks in relation to revenue recognition and management override of controls and have satisfactorily concluded our work in these areas. Our audit strategy overview and plan also identified areas of audit focus in respect of accounting for the property lease compensation and the control of operating expenditure. We have satisfactorily concluded our work in these areas.	Pages 9 and 10
Year-end process	The draft financial statements and remuneration report were received by the agreed date and were supported by good quality working papers. Financial statements incorporating the Strategic Report, Foreword and Governance Statement were received during the audit fieldwork. There were a few presentational corrections and an adjustment in respect of pensions accounting that were processed by management during the audit.	Page 11

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Headlines (continued)

Area	Summary observations	Analysis
Financial reporting and accounting (continued)		
Control observations	Our testing 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.	Page 14
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.	Page 14
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, which this year resulted in lower legal costs compared to the prior year.	Page 16

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Scope and responsibilities

Purpose of this report

The Auditor General for Scotland (“the Auditor General”) has appointed KPMG LLP as auditor of Scottish Legal Complaints Commission (“the Commission”) under the Public Finance and Accountability (Scotland) Act 2000 (“the Act”). The period of appointment is 2011-12 to 2015-16, inclusive.

Our annual audit report is designed to summarise our opinion and conclusions on significant issues arising from our audit. It is addressed to both those charged with governance at the Commission and the Auditor General for Scotland. The scope and nature of our audit were set out in our audit strategy document which was presented to the audit and risk committee at the outset of our audit.

Responsibilities

Audit Scotland’s *Code of Audit Practice* (“the Code”) sets out the Commission’s responsibilities in respect:

- preparation of financial statements;
- systems of internal control;
- prevention and detection of fraud and irregularities;
- standards of conduct and arrangements for the prevention and detection of bribery and corruption;
- financial position; and
- Best Value.

This report reflects our overall responsibility to carry out an audit in accordance our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code.

The Code sets out the wider dimensions of public sector audit which involves not only the audit of the financial statements but also consideration of areas such as financial performance and corporate governance.

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. Weaknesses or risks identified 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. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Under the requirements of International Standard on Auditing (UK and Ireland) (‘ISA’) 260 *Communication with those charged with governance*, we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity.

This annual audit report to members and our presentation to the audit committee, together with previous reports to the committee throughout the year, discharges the requirements of ISA 260.

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Service overview

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

Key business issues and financial position

The Commission operates deficit budgets, drawing on reserves and cash generated in prior years. The actual result for 2013-14 was break-even.

The 2014-15 budget incorporates broadly consistent income to the 2013-14 budget, with lower total expenditure. This reflects the continued development of the efficiency of the Commission.

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 2012-13 £'000	Budget 2013-14 £'000	Actual 2013-14 £'000	Budget 2014-15 £'000
Operating income	(2,720)	(2,709)	(2,757)	(2,696)
Staff costs	1,886	2,184	1,874	2,020
Other administrative costs	1,072	729	883	752
Net operating cost	**238**	**204**	**-**	**76**
Actuarial (gain)/loss on pension scheme	(14)	-	41	-
Net deficit	**224**	**204**	**41**	**76**

Source: KPMG analysis of management schedules

Financial position

As set out in the table opposite, budgeted income for 2013-14 was £2.709 million, with expenditure of £2.913 million.

Actual income was £2.757 million, with the £0.048 million surplus to budget reflecting complaints levies, which are not budgeted, as well as greater interest income from the higher than forecast cash balance.

Actual expenditure was £0.156 million lower than budget at £2.757 million. The key variances were:

- staff costs were £0.310 million lower than budget, primarily due to removing the position of Operations Director and leavers being at a more senior grade than the new starters;
- greater depreciation and amortisation (£0.094 million) compared to the budget of £0.036 million. This was a result of the first full year amortisation for Work pro which was not included in the budget; and
- higher property costs of £0.321 million compared to a budget of £0.31 million.

The net deficit of £0.041 million, after an actuarial loss of £0.041 million, resulted in a general reserve as at 30 June 2014 of £0.737 million, with a cash balance of £1.056 million. This represents around three month's budgeted expenditure; in line with the Commission's reserves policy.

The actuarial loss gave rise to an increase in the pension scheme liability and primarily represents an increase in the present value of the defined benefit obligation, reflecting the reduction in the discount rate assumption.

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Key business issues and financial position

2014-15 budget

In the past a contingency provision was including within the budget. Management has not incorporated into the 2014-15 budget as the individual budget lines are considered to be appropriate on the basis of prior year experience.

Total expenditure is budgeted at £2.773 million; broadly consistent with the 2013-14 expenditure of £2.757million. 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.

2014-15 levy income was budgeted to be consistent with 2013-14 at £2.671 million. The budget therefore incorporates a further underwriting of the Commission’s expenditure from reserves, with a budgeted transfer from general reserve of £0.076 million. We understand that actual levy income in 2014-15 will be higher than budgeted as a result of a greater number of legal practitioners than originally forecast.

Complaints handling

Complaints in hand as at 30 June 2014 were 487, being a 22% decrease on 30 June 2013 compared to only a 9% reduction in complaints received. Improvements to the complaints handling process have resulted in 37% more cases being resolved prior to going to determination. However the Commission closed 6% less complaints in 2013-14 compared to 2012-13.

In our audit strategy overview document we noted that management had recognised a provision of £30,000 in respect of purported decisions made when not quorate. We understand that, following consideration of the related cases, £6,000 of the provision was utilised and the remaining balance was released.

Property lease

The lease agreement for the Stamp Office included a lease break option, which could be exercised in December 2012. 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.

A settlement was reached, totalling £200,000, which was received on 24 February 2014. The reduced rent would have been applicable from 8 September 2013, hence a pro rata amount of £0.032 million was released to match against the greater lease cost expenditure. The remaining balance is deferred, as discussed and agreed with management prior to the year end. We concur with management that immediate recognition of the receipt would not be appropriate in light of the length of the lease.

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Financial statements and accounting

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

Audit conclusions and significant risks

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

International Standards on Auditing require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk and that management override of controls is a significant risk. We have satisfactorily carried out audit work to address these risks.

Audit conclusions

Following approval of the financial statements by the board, we have issued an unqualified opinion on the truth and fairness of the state of the Commission's affairs as at 30 June 2014, and of the Commission's deficit for the year then ended. We have also issued an 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;
- reviewed the internal audit report issued in the year, 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.

Significant risks

Revenue recognition	The majority of the Commission's income is received by way of levy collected by the Law Society of Scotland. As the levy is agreed in advance of the financial year and received upfront, we do not regard the risk of fraud in respect of recognition of this income as significant. We confirmed the accuracy of the levy presented in the financial statements without exception. Other sources of income generally relate to complaints levies or bank interest which are accounted for on an accruals basis. The amounts recognised are not material and the results of our testing did not identify any required adjustments.
Management override of controls	To address this risk, we performed testing of journal entries during the year and at the year end, undertaken a review of unusual transactions in the year, made enquiries with employees outside the finance department, incorporated audit tests of an unpredictable nature and undertaken testing of controls, including 'higher level' controls and reviewed management's accounting estimates for bias. Our work did not identify any matters that required adjustment in the financial statements or which require to be brought to your attention.

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Audit focus areas, accounting policies and going concern

The Commission has applied the revisions to IAS 19 Employee Benefits. All other accounting policies have been applied consistently.

Other than revisions to IAS 19 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.

Other audit focus areas	■ The audit strategy overview document identified other areas of audit focus in respect of financial position, accounting for the property lease compensation and expenditure. During the audit we also identified an additional audit focus area in respect of provisions. ■ We include narrative in respect of financial position on page six of this report and results of our testing of expenditure controls on page 14. Further consideration of provisions is included on page 12.
Financial reporting framework	■ The Commission prepares financial statements in accordance with the principles of the Government's Financial Reporting Manual 2013-14 ("FReM") and we are satisfied that the accounting policies adopted remain appropriate to the Commission. ■ Changes to the FReM in 2013-14 require the Commission to prepare a strategic report in line with section 414C of the Companies Act 2006 as interpreted by the FReM. The strategic report requirements include disclosures previously required within the directors' report or foreword and new disclosures (if not previously included) on social, community and human rights issues, a description of the body's strategy and business model and a gender break down of directors, senior managers and employees. Appropriate disclosure has been included within the strategic report.
Impact of revised accounting standards	■ The Commission has applied the revisions to IAS 19 Employee Benefits, opting not to restate the prior year comparatives on grounds of materiality. We concur with this approach as there were no changes to the statement of financial position as a result of the retrospective application of IAS19R, and the impact on the statement of consolidated income and expenditure are not material. Appropriate disclosure has been provided within the accounting policies note. ■ There are no other newly effective accounting standards that are considered to have a material impact on the Commission's financial statements in the current year. Appropriate disclosure to this effect is included within the accounting policies note to the financial statements.
Going concern	■ The financial statements have been prepared under the assumption that the Commission 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 2014-15 is broadly balanced and the Commission holds cash of over £1 million.

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Financial statements preparation

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

Financial statements preparation	■ Draft financial statements and good quality working papers were provided at the start of the audit fieldwork. This included the foreword although not the governance statement and strategic report, both of which were received during the audit fieldwork. ■ 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. ■ Prior to the audit we had correspondence with the finance team to ensure that disclosure within the financial statements was consistent with the requirements of the FReM, particularly in respect of the strategic report and revised remuneration report requirements. We identified presentational adjustments in respect of pension disclosures, which 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.

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Other audit focus areas 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
Accrual for legal related costs	3	3	(70)	The accrual for legal costs has increased compared to the prior year, from £0.028 million to £0.07 million. This reflects the greater number of appeals against determinations committee decisions. The accrual is management's best estimate of the external legal and legal related costs to be incurred where the appeal had not concluded as at 30 June 2014. The estimate is based on management's past experience. We reviewed the case status and considered the accuracy of the prior year estimate, which was broadly appropriate. The accrual is inherently judgemental and, in light of the information available to management, we are content with the value of the accrual.
Bad debt provision	2	3	(53)	The bad debt provision of £0.053 million is in respect of gross complaints levy debtors of £0.059 million and represents an increase of £0.018 million on the prior year. The provision relates to 22 legal firms whose debts are over three months old and where recovery is considered doubtful. Management is actively pursuing recovery of all debts. The Commission has an obligation to respond to complaints in respect of legal firms and where management are aware that the related firm is in financial difficulty the levy debtor is provided in full immediately. At the audit fieldwork stage, subsequent to the year end, £804 had been recovered; supporting the need for a provision. In light of the circumstances we concur with the need for a provision, and consider it is prudent.

Level of prudence

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

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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.

Testing of controls around risk points has not identified weaknesses or operating exceptions.

Annual governance statement and governance arrangements	The governance statement for 2013-14 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. The statement, which is made by the accountable officer, considers the effectiveness of the system of internal control based on information provided by the audit and risk committee and internal audit. The statement identifies that there have been no significant risk-related matters. 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.
Annual report, including the strategic report and foreword	The financial statements form part of the annual report of the Commission for the year ended 31 March 2014. Following amendments to the Companies Act becoming effective for 2013-14, the Commission is required to include both a strategic and a director's report as part of the annual report. We have reviewed the contents of the strategic and directors' report against the revised disclosure requirements and are content with the proposed reports. We provided management with some relatively minor suggestions relating to how the reports could be enhanced and / or where additional information disclosures should be made. We are required to consider the strategic and directors' reports, and provide our opinion on the consistency of it with the financial statements: we are satisfied that the information contained within the strategic and directors' report is consistent with the financial statements.
Internal controls	We have identified no control weaknesses during our work and note that management has continued to apply segregation of duties. The internal audit review of core financial systems also did not identify any significant control weaknesses, although noted areas of enhancement.

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Corporate governance arrangements (continued)

Remuneration report	The remuneration report was included within the draft financial statements and supported by good quality information and working papers. The 2013-14 FReM included an additional requirement for disclosure of total directors' remunerations as a single figure; this has been correctly included within the financial statements.
Internal audit	We reviewed the work of internal audit in 2013-14 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 (financial ledger, expenditure and payables and budgetary control) ■ IT security (draft report) 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 of 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 June 2014 a member of staff exposed the Commission to a fraud by way of responding to an e-mail scam, which resulted in £40,000 being withdrawn from the current account. The fraud was identified immediately by management and the amount recovered from the bank. Management is considering the response to the case and ensured that all staff were alerted to the risk of executable files within e-mails. No further significant or other fraud or irregularity was identified by management, internal audit, or through the course of our external audit work.

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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 Government's original 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. The contracts with legal firms were put out for tender during 2013-14 and the process was overseen by the in-house lawyer. The most significant cost of the Commission is in respect of salaries. 1% pay rises were applied following approval from the Scottish Government Remuneration Group in the prior year. 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 over the core financial systems during 2013-14 and concluded that there were no major weaknesses.

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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. 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	£10,450 - audit fee No non-audit services were provided in 2013-14	-
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.	-

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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.

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 Scottish Legal Complaints 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
- 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 13 October 2014, 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 letter 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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