



INFRASTRUCTURE, GOVERNMENT &
HEALTHCARE

Scottish Legal Aid Board

Annual audit report to the
Scottish Legal Aid Board and the
Auditor General for Scotland
2006-07

7 September 2007

AUDIT

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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 only the Scottish Legal Aid Board 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.

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If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Grant Macrae, who is the engagement leader for our services to the Board, telephone 0131 527 6611, email grant.macrae@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Lorraine Bennett, our Head of Audit in Scotland, either by writing to her at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 222 2000 or email to lorraine.bennett@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Director of Audit Strategy, Audit Scotland, 110 George Street, Edinburgh, EH2 4LH.



Executive summary

This report summarises our work for the 2006-07 year and our findings in relation to our audit of the financial statements, corporate governance arrangements, and performance management arrangements.

Financial statements

On 7 September 2007 we issued an audit report giving our unqualified opinion on the financial statements of the Board for the year ended 31 March 2007 and on the regularity of transactions reflected in those financial statements.

The financial statements reflect the change in accounting policy to account for government funding as financing rather than income.

The provision for legal aid incurred and not paid at the year end increased by £10 million to £89 million at 31 March 2007.

Corporate governance

The director of audit and compliance issued an assurance statement to the chief executive, concluding that "*there is nothing which would warrant the accountable officer not signing the standard form of the statement of internal control in the Board's report and accounts for the year to 31 March 2007, and I do so recommend*". Responsible officers and the audit committee provide a statement of assurance to the chief executive to assist in his preparation of the statement on internal control.

Our testing of the design and operation of controls over entity level controls and significant risk points in key financial processes confirms that, subject to the minor weaknesses reported, controls are designed appropriately and operating effectively.

Net cash expenditure by the Scottish Legal Aid Fund and Scottish Legal Aid was within cash allocations from the Scottish Executive Justice Department.

Performance management

There are strong performance management arrangements in place and performance against performance indicators is monitored on a regular basis.

Introduction

Audit framework

This was the first year of our five-year appointment as external auditors of the Scottish Legal Aid Board ("the Board"). We refer to the Board throughout this document, except where we specifically discuss the financial statements of either the Scottish Legal Aid Fund ("the Fund") or the Scottish Legal Aid Board ("Grant-in-Aid").

This report to the Board and the Auditor General for Scotland outlines our opinion and conclusions and highlights significant issues arising from our work.

In accordance with Audit Scotland's *Code of Audit Practice* ("the Code"), the scope of the audit was to:

- provide an opinion on the Board's financial statements and, as required by relevant authorities, the regularity of transactions;
- review and report on (as required by relevant legislation, the Code and any guidance issued by Audit Scotland):
 - the Board's corporate governance arrangements as they relate to: its review of systems of internal control; the prevention and detection of fraud and irregularity; standards of conduct, and prevention and detection of corruption; and its financial position
 - the Board's arrangements to achieve Best Value
 - other aspects of the Board's arrangements to manage its performance, as they relate to economy, efficiency and effectiveness in the use of resources.

The framework under which we operate under appointment by Audit Scotland was outlined in the audit plan for the year discussed with the Board's risk monitoring and audit committee.

Responsibilities of the Board and its auditors

External auditors do not act as a substitute for the Board's own responsibilities for putting in place proper arrangements to account for its stewardship of resources made available to it and its financial performance in the use of those resources, to ensure the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the effectiveness of those arrangements and, through accountable officers, to make arrangements to secure Best Value.

Acknowledgement

We wish to place on record our appreciation of the co-operation and assistance extended to us by Board staff during the first year of our work in the discharge of our responsibilities.

Financial statements audit

Audit opinion

On 7 September 2007 we issued an audit report expressing an unqualified opinion on the financial statements of the Board for the year ended 31 March 2007 and on the regularity of transactions reflected in those financial statements. We bring the following issues to the Board's attention.

[Presentation of the financial statements](#)

The Board is required to prepare its financial statements in compliance with the financial reporting manual ("FReM") issued by HM Treasury, as stated in the accounts direction. From 2006-07 the FReM requires that all central government financial statements include an operating cost statement ("OCS") as the primary income statement, rather than an income and expenditure account.

Grants and grant-in-aid received for revenue purposes from the Scottish Executive were previously shown as income, but this has changed so that such amounts shall be considered as contributions from controlling parties giving rise to a financial interest in the residual interest of the body, and hence should be accounted for as financing.

This change represents a change in accounting policy and therefore requires a prior year adjustment to reflect changes in the previously reported financial statements. This treatment complies with the requirements of both FRS 3 'reporting financial performance' and the FReM. As a result, the financial statements include a number of additional disclosures in the primary financial statements, accounting policies, and notes to the financial statements. Management's presentation of this adjustment in the draft financial statements was of a high quality, but some presentational amendments were required to ensure compliance with FRS 3.

[Legal aid accrual](#)

The financial statements disclose a provision of £89 million (2006: £79 million) to reflect legal work performed but not paid in the period to 31 March. At 31 March 2006 this was disclosed as an accrual, but management now consider that the balance meets the definition of a provision and has reclassified the amount in the balance sheet. Financial reporting standard 12 'provisions, contingent liabilities and contingent assets' ("FRS 12") requires that "a provision should be recognised when an entity has a present obligation ... as a result of a past event, it is probable that a transfer of economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation".

A provision is an estimate at a point in time and the real accuracy of this estimate can only be judged on cash payment of the obligation. Management has confirmed that there have been no events during the period after 31 March that could indicate that the provision is materially misstated, but there is no formal process of post year end evaluation of the provision. In future years we would encourage management to implement a process whereby there is evidence of formal consideration of the average case costs between 1 April and the date the financial statements are signed. Management will benefit from assurance that the provision is based on reasonable assumptions and not materially misstated.

We reviewed the controls operating over the Oracle system used by management to generate the provision at 31 March and identified controls in place over access to amend the Oracle system and a programme of system testing. To enhance the processes in place and provide assurance to management over the operational of these key controls we recommend that:

- there should be evidence of independent review of the year end date change within the Oracle system; and
- documentation of the testing performed should be sufficiently detailed to allow re-performance of the tests completed.

Operating leases

The Board's offices in Edinburgh are used under an operating lease, due to expire in 2014. It is common for an operating lease to require refurbishment or other internal works prior to vacating the premises at the end of the lease. The estimated cost of such work would be charged as expenditure during the period of the lease, building up a provision to be used to cover the costs to be incurred in the final year. Management has confirmed that the lease agreements require that the building is maintained to a reasonable standard and that there is no requirement for extensive refurbishment at the end of the lease term. This is consistent with our understanding based on the lease agreements provided. There is a regular programme of maintenance, including painting and decorating, to minimise the risk of future work. On this basis, management has not provided for dilapidations, which is considered reasonable. Management should continue to consider the likelihood of future costs to be incurred, particularly as the end of the lease term approaches.

Corporate governance

Introduction

Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all bodies.

Through its chief executive, as accountable officer, the Board are responsible for establishing arrangements for ensuring the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. The *Code* requires auditors to review and report on the Board's corporate governance arrangements as they relate to:

- the Board's reviews of its systems of internal control, including its reporting arrangements;
- the prevention and detection of fraud and irregularity;
- standards of conduct and arrangements for the prevention and detection of corruption; and
- its financial position.

Systems of internal control

Statement on internal control ("SIC")

The SIC provides details of the risk and control framework and the overall system of internal control. No significant weaknesses have been included in the statement of internal control. The director of audit and compliance issued an assurance statement to the chief executive, concluding that "*there is nothing which would warrant the accountable officer not signing the standard form of the statement of internal control in the Board's report and accounts for the year to 31 March 2007, and I do so recommend*".

The chief executive obtained evidence from managers, the audit committee, board and director of audit and compliance to support his assessment of the operation of the system of internal control.

Governance arrangements and risk management

The Board has a strong risk management process. Management has established a formal risk policy, incorporating a risk management framework, which is supported by the strategic risk register. The board takes ownership of the process at the strategic level, supported by the audit committee and executive team, who are responsible for implementing policies and processes at an operational level

Internal audit

Internal audit have completed work in accordance with the annual audit plan and concluded that the Board has "*a generally sound framework of control which provides reasonable assurance regarding the effective and efficient achievement of the Board's objectives*".

Internal controls

Our testing of the design and operation of controls over significant risk points confirms that, subject to some minor weaknesses reported, controls are designed appropriately and operating effectively. We have reported some areas where the control environment could be enhanced and management has accepted these recommendations.

Prevention and detection of fraud and irregularity

The fraud prevention policy is available to all staff on the intranet, which defines fraud and specifies responsibilities for the prevention and detection of fraud. The policy also incorporates a fraud detection and response strategy and whistle-blowing policy. The director of audit and compliance is responsible for monitoring the operating effectiveness of controls to prevent and detect solicitor fraud i.e. fraudulent claims for legal aid. The results of this process are reported to the board and audit committee throughout the year.

Standards of conduct

The staff code of conduct, available on the intranet, considers duties, responsibilities and accountability, conflicts and interests, integrity, and use of resources and official information. The separate code of conduct for members is based on the Nolan principles and provides guidance on allowances, gifts, hospitality and expenses, registration of interests, and access to members of public bodies.

Financial position

The outturn report in the financial statements is shown below:

	<i>Net operating costs (£'000)</i>	Cash expenditure (£'000)	Funding allocation (£'000)	Outturn (£'000)
Scottish Legal Aid Fund	155,675	149,000	142,200	(6,800)
Scottish Legal Aid Board	14,252	12,814	12,900	86

Scottish Legal Aid Fund

The nature of legal aid and complexity of relevant legislation means that expenditure is demand led and therefore unpredictable in timing and volume. Section 40 of the Legal Aid (Scotland) Act 1986 states that "*The Secretary of State shall pay to the Board out of moneys provided by Parliament ... such sums as are required ... to meet payments out of the Fund under this Act*". As a result, expenditure is not cash limited. During the year, management submit a monthly vote monitoring return detailing cash drawn down to date and forecast cash required to 31 March 2007 in line with Scottish Executive Justice Department requirements. Management drew down £149 million in cash during the year, which is consistent with correspondence with the Scottish Executive Justice department. Varying amounts of time can elapse between incurring the expenditure, on an accruals basis, and making the legal aid cash payment, resulting in the significant difference between cash and accruals based expenditure.

Scottish Legal Aid Board

Net cash expenditure for the year is within the cash allocation from the Scottish Executive Justice Department. The additional accruals-based and notional expenditure primarily relates to non-cash pension costs.



Net liabilities

The Fund balance sheet at 31 March 2007 reported net liabilities of £79 million (2006: £70 million) due to the carrying value of provisions for liabilities and charges. Net liabilities in the Grant-in-Aid balance sheet were £36 million at 31 March 2007 (2006: £25 million), which equates to the value of pension scheme liabilities at the balance sheet date. Provisions and pension scheme liabilities have been accounted for under financial reporting standards 12 'provisions for liabilities and charges' and 17 'retirement benefits'. Management has received a 'letter of comfort' from the Scottish Executive indicating that cash will be available in future years to fund cash payments as these fall due.

Performance management

Overall arrangements

The corporate plan details the annual objectives and performance indicators. The annual report summarises performance during the year and we understand that management will report that the six headline performance indicators were met during 2006-07. These indicators measure the timeliness, consistency and accuracy of processing of legal aid applications and accounts. Performance indicators are reviewed on an annual basis to ensure they continue to reflect the Board's services and the needs of legal aid applicants. Performance is regularly reported to the board and the appropriate governance committee.

Best Value

The Board was subject to an overview assessment of the arrangements to secure Best Value in 2005-06. Audit Scotland issued a report to the Board in September 2006, detailing the findings of their work. Seven out of the ten areas included in the review were found to be 'well developed' to secure Best Value. Equal opportunities and joint working were assessed as 'under development'. Arrangements for sustainable development were assessed as 'planned'. Management has made progress during 2006-07, with particular focus on the three areas highlighted for specific action. Actions taken include:

- publication of a disability equalities scheme, in addition to the existing race equalities scheme, and development of a draft gender equalities scheme;
- introduction of a mechanism to ensure routine use of the recently developed equalities impact tool for all Board projects;
- contribution to identification of 11 pilot projects to develop shared services in non-departmental public bodies;
- a review of the environmental policy, including identification of specific water consumption and recycled paper usage targets for 2007-08 and beyond; and
- development of a system to measure the Board's carbon footprint.

Efficient government

Targets set by the Scottish Executive for 2005-06 and 2006-07 were exceeded, primarily achieved through regulatory changes to legal aid. In 2006-07 management reported cash releasing efficiency savings of £9.1 million (target £9.0 million). The original target for efficiency savings in 2007-08 was £12 million, but this has been reduced to £9 million. Progress towards targets is reported to the executive team and the board during the year. The Board actively contributes to the changing agenda and works closely with the Scottish Executive, but the timing of changes in legislation and regulations can have an impact on the recognition of savings.

Appendix – action plan

Priority rating for performance improvement observations raised		
<p>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 Board or systems under consideration. The weakness may therefore give rise to loss or error.</p>	<p>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.</p>	<p>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 controls to meet their objectives in any significant way. These are less significant observations than grades one and two, but we still consider they merit attention.</p>

No.	Issue and performance improvement observation	Management response	Officer and due date
1	<p>Management has confirmed that there have been no events during the period after 31 March that could indicate that the provision for legal aid is materially misstated, but there is no formal process of post year end evaluation of the provision.</p> <p>In future years we would encourage management to implement a process whereby there is evidence of formal consideration of the average case costs between 1 April and the date the financial statements are signed. Management will benefit from assurance that the provision is based on reasonable assumptions and not materially misstated.</p> <p><i>Grade one</i></p>	Agreed.	<p>Director of corporate services and accounts</p> <p>31 August 2007</p>

2	<p>There are controls over access to amend the Oracle system used to calculate the legal aid provision and a programme of system testing.</p> <p>To enhance the processes we recommend that:</p> <ul style="list-style-type: none"> • there should be evidence of independent review of the year end date change within the Oracle system; and • documentation of the testing performed should be sufficiently detailed to allow re-performance of the tests completed. <p><i>Grade two</i></p>	Agreed.	Financial accountant 31 December 2007
3	<p>There is no formal process to monitor compliance with general laws and regulations, including circulars issued by the Scottish Executive and other government bodies. There is a risk the Board fails to comply with laws and regulations.</p> <p>There is a process in place for all legal aid circulars but this does not extend to general guidance such as procurement, health and safety etc.</p> <p>The Board should review the current systems established across the organisation with a view to establishing formal system of monitoring the action taken to comply with guidance and circulars. If no action is required this should be recorded.</p> <p><i>Grade two</i></p>	We recognise the need to formalise the current arrangements that already exist as part of the routine operational reporting, internal audit checking and annual assurance processes.	Director of corporate services and accounts 31 December 2007

