

**SRA Board**  
13 September 2016

**CLASSIFICATION – PUBLIC**



## **Compensation Fund 2015 Financial Statements**

### **Purpose**

- 1 This paper presents the Compensation Fund 2015 Financial Statements, Letter of Representation, Engagement letter and Statement of Responsibilities for the year ending 31 October 2015. The information within this paper was presented to the Finance and Audit Committee on 19 April 2016 with updates provided on 9 September 2016.

### **Recommendation**

- 2 The Board is asked to:
  - a) agree the Compensation Fund 2015 Financial Statements and Letter of Representation.

**If you have any questions about this paper please contact: Richard Collins  
Executive Director, Strategy and Resources, [richard.collins@sra.org.uk](mailto:richard.collins@sra.org.uk)**

*This paper is marked official because it contains sensitive information.*

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## **Compensation Fund 2015 Financial Statements**

### **Introduction**

- 3 As part of the year end external audit process the Board is asked to approve the 2015 year-end Financial Statements and the signing of the Letter of Representation to the auditors. The Letter of Representation makes representations based on enquiries of management and staff with relevant knowledge and experience and, where appropriate, inspection of supporting documentation.
- 4 To provide assurance to the Board to enable it to make these representations, a review was undertaken of the work already performed by the external auditors. This work was then mapped to the specific representations required in the Letter of Representation and to the Compensation Fund Financial Statements. Where this identified additional assurance was required Deloitte was engaged to perform additional independent testing.
- 5 During 2016 we obtained independent legal advice as to the legal status of the Fund. This advice identified that the Fund was not a statutory trust controlled by trustees subject to private law trust duties as it had been described in prior years, but was in fact a fund held by the Law Society for the benefit of others and prescribed statutory purposes. The Financial Statements and Letter of Representation presented for the 2015 year-end have been updated in conjunction with the SRA legal team to reflect this change, and the appropriate description of the governance surrounding the Fund. The description of the updated process has also been reviewed by our external auditors.
- 6 Due to the impact of the legal status of the Compensation Fund on the governance structure the external auditors require their Engagement Letter to be re-issued and signed on behalf of the Board.
- 7 The results of the work performed are summarised below.

### **Executive summary**

- 8 Deloitte performed substantive testing over grant payments, subrogations from the Statutory Trust Accounts (STAs), external grant recoveries and residual balance recoveries. 195 items were tested giving coverage between 72% and 95% by value where applicable. The work performed by Deloitte identified misstatements in two areas totalling circa £200k in value. These misstatements had no impact on the primary statements, closing reserves or cash balances.
- 9 Of the work performed by the external auditors and additional testing performed by group finance no further misstatements were identified.

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10 Where adjustments have been found these have been updated within the notes to the financial statements. The external auditors have reviewed this work and confirmed that no further adjustments were required.

**Recommendation:**

**a) to agree the Compensation Fund 2015 Financial Statements and Letter of Representation.**

**Author** Matthew Robinson, Head of Financial Accounting

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**Date** 16 August 2016

**Annexes**

**Annex 1** Compensation Fund 2015 Financial Statements

**Annex 2** Letter of representation

**The Law Society Compensation Fund  
Annual Report and Financial Statements  
For the Year ended 31 October 2015**

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## **Principal activities**

The primary object of the Compensation Fund (the Fund) is to replace money which a defaulting practitioner or a defaulting practitioner's employee or manager has misappropriated or otherwise failed to account for.

The Fund makes discretionary grants to those persons who have either:

- suffered loss as a consequence of the dishonesty of a defaulting practitioner or the employee or manager or owner of a defaulting practitioner; or
- suffered loss and hardship in consequence of a failure to account for money which has come into the hands of a defaulting practitioner or the employee or manager or owner of a defaulting practitioner.

The majority of these grants arise from claims made following an intervention by the Solicitors Regulation Authority (SRA) into the practice of a defaulting practitioner.

Regulated individuals and licensed bodies are required to pay an annual contribution to the Fund. Contributions are determined and collected on behalf of the Fund by the Law Society of England and Wales (the Society).

## **Governance**

The Council of the Law Society (the Council), as the governing body of the Society has ultimate accountability for maintenance of the Fund in accordance with the SRA Compensation Fund Rules 2011 which are made under sections 36 and 36A of the Solicitors Act 1974, section 9 of the Administration of Justice Act, sections 21(2) and 83(5)(e) of, and paragraph 19 of Schedule 11 to, the Legal Services Act 2007 and an Order made under section 69 of the Legal Services Act 2007, S.I. 2011 No 1716, with the approval of the Legal Services Board under paragraph 19 of Schedule 4 to the Legal Services Act 2007.

The management of the Fund has been delegated by the Council to the Solicitors Regulation Authority Board (the Board) of the Law Society and the administration of the Fund is governed by the SRA Compensation Fund Rules 2011.

Reference throughout this document to “the Society” refers to the Law Society as a royal charter body which consists of the Law Society professional body (TLS) and the Solicitors Regulation Authority (SRA).

**Governance (continued)**

Members of the Board during the financial year under review were:

Enid Rowlands	Chair from 1 January 2015
Julia Black	Member
Graham Chisnall	Member
Martin Coleman	Member
Jane Furniss	Member
Bill Galvin	Member
David Heath	Member
Cindy Leslie	Member
Moni Mannings	Member
Paul Marsh	Member
Peter Phippen	Member
Chris Randall	Member
Shamit Saggarr	Member
Elaine Williams	Member
David Willis	Member
Tom Keevil	Member until 31 December 2014
Sara Nathan	Member until 31 December 2014
Charles Plant	Chair until 31 December 2014

Chief Executive of the SRA:

Paul Philip

### **Governance (continued)**

The Board similarly delegated certain powers and duties during the financial year to the Finance and Resources Committee and the Standards Committee. These committees advise the Board on all policy and technical matters relating to the Fund and professional indemnity.

Members of the Finance and Resources Committee during the financial year under review were:

Graham Chisnall	Chair
Bill Galvin	Member
Tom Keevil	Member until 31 December 2014
Charles Plant	Member until 31 December 2014
Peter Phippen	Member
David Willis	Member from 1 June 2015

Members of the Standards Committee during the financial year under review were:

Sara Nathan	Chair until 31 December 2014
Julia Black	Chair from 1 January 2015
Suki Binjal	Member
Jonathan Kembery	Member
Harriet Territt	Member
Sue Thomas	Member
Jane Furniss	Member
Moni Mannings	Member
Chris Randall	Member
Howard Webber	Member
Barbara Saunders	Member
Elaine Williams	Member from 1 June 2015

Given the Council's size (there are 100 places on the Council) the membership records are not shown here but are available on request and are included in the consolidated financial statements of the Law Society Group.

## **Operating and financial review**

### **Results for the year**

#### **Contributions**

Contributions are collected annually, as part of the annual practising fee collection process, by the Society on behalf of the Fund. These contributions form part of the overall Fund balance and may be used to provide cover for future claims in any year against the Fund.

A contribution of £32 per individual and £548 per firm which holds client money (2014: £32 and £548 respectively) was approved by the Board at their meeting in June 2015 relating to the practising fee year 1 November 2015 to 31 October 2016.

The contribution remaining as in the prior year, reflects the continued decision of the Council and the Board to reduce the sizeable reserves held in the Fund. The total budgeted contribution for the 2015/16 practising year was £8.5m which is consistent with the 2014/15 practising year.

Of the budgeted £8.5m in relation to the 2015/16 practising fee year, £6.5m had been invoiced at the end of October 2015 (2014: £6.1m) with the remainder being invoiced by the end of January 2016. Contributions recognised during the year totalled £9.1m compared with £10m in 2014.

#### **Investment income**

Investment income decreased by £119k to £111k in 2015, this decrease was due to investment being made in longer term cash deposits which had not matured at the year end. Up to 31 October 2015 £209k of interest has accrued on this investment but has not been recognised within these financial statements. At the end of October 2015 the Fund had £39.7m in cash and investments compared with £62.7m at the end of October 2014.

#### **Grants paid and grant recoveries**

During the year to 31 October 2015 grants were made to the value of £17.9m (2014: £23.8m).

In 2015 grant recoveries were £7m, an increase of £0.6m from 2014 (2014: £6.4m). Recoveries are often received several months or even years after the initial grant is paid and therefore are not necessarily related to grants paid in the same year due to the accounting policies adopted. Grants are recovered primarily from Statutory Trust Accounts held by the Society (see below for further details).

The Fund received 1,174 claims in 2015 (2014: 1,842) and closed 1,430 (2014: 2,015). At the end of the year there were 292 open claims (2014: 548) with a total amount of £36.8m (2014: £43.8m) (see note 9 for further information). The average claim amount open at the year end is higher than in the prior year (2015: £126k, 2014: £80k).

## **Operating and financial review (continued)**

### **Statutory Trust Accounts (STAs)**

The Society is the Trustee of separate funds held as a result of interventions into solicitors' practices and as Trustee is responsible for ensuring that the funds are properly accounted for and distributed appropriately. These funds are held in STAs. The Fund is able to recover from the STAs and other avenues (e.g. insurers), via right of subrogation, grants it has made where the funds held can be identified as due to a claimant who has received a grant from the Fund.

Monies received by the Fund via right of subrogation during 2015 totalled £7m compared to £6.4m in 2014.

Once all reasonable and proportionate efforts have been made to trace beneficiaries, any residual balances remaining in STAs are transferred to the Compensation Fund. In 2015 the amount transferred was £0.6m (2014: £1.8m).

Of the total grant recoveries, £1.5m (2014: £0.2m) relates to monies recovered by cost recovery where the Fund is able to recover from solicitors, grants that have been paid out to former clients of those solicitors. The significant increase in the year is due to timing of recoveries being remitted from the Society to the Compensation Fund with £0.5m being due for remittance at 31 October 2014. Remittances are now carried out on a monthly basis. The remainder is as a result of the Compensation Fund bearing the cost of all interventions since mid 2013.

### **Administrative costs**

Costs incurred during the year in administering, maintaining, applying and protecting the Fund were £10.5m (2014: £10.6m). Almost all Fund administrative costs are incurred by the Society and recharged to the Fund in accordance with agreed methodology and cost allocation rates. The most significant element of the recharge relates to third party intervention and legal costs incurred by the Society, the remaining costs considered in calculating the recharge include Society direct staff costs and the Society's central services costs which incorporate Finance, Human Resources and Development, Facilities and IT. The administrative costs which are not incurred by the Society include bank charges and auditor fees for non-audit services.

### **Result for the year**

The deficit for the year was £11.5m (2014: £16m). The movement of the deficit from the prior year mainly arises as a result of a significant decrease in the grants paid in the year coupled with a lessor decrease in contributions and grant recoveries.

## **Operating and financial review (continued)**

### **Balance sheet and cash flow**

Accumulated funds as at 31 October 2015 were £44.5m, compared with £56m as at 31 October 2014.

Reserves are expected to reduce throughout most of 2016 as the majority of the income in relation to the 2015/16 practising year was invoiced at the end of 2015. Contributions for the 2016/17 year are due to be collected from October 2016.

Analysis of open claims on the Fund along with the expected inflows into the fund in the form of recoveries provides confidence that these reserves are sufficient to meet future obligations.

### **Current assets**

Current assets have decreased by £18.8m overall. The balance in the bank has decreased significantly in the year due to the maturity of a £25m investment in September 2014 with re-investment being made in March 2015.

The Compensation Funds' investments are now split between investments in Standard Chartered and Barclays Global Investors.

The amount held by the Fund in cash is intended to be kept at minimal levels required to support day to day requirements.

### **Principal risks and uncertainties**

As stated on page 1, the primary object of the Fund is to make discretionary grants to those persons who have either:

- suffered loss as a consequence of the dishonesty of a defaulting practitioner or the employee or manager or owner of a defaulting practitioner; or
- suffered loss and hardship in consequence of failure to account for money which has come into the hands of a defaulting practitioner or the employee or manager or owner of a defaulting practitioner.

As such the principal risk of the Fund is that it holds insufficient accumulated funds to settle authorised grants or that grants are made in inappropriate circumstances.

The above risks are mitigated by the fact that grants from the Fund are discretionary as outlined in rule 3.3 of the SRA Compensation Fund Rules 2011<sup>1</sup> (A grant out of the Fund is made wholly at the discretion of the Society. No person has a right to a grant enforceable at law). However, in practice the Society must act in the public interest when approving claims made against the Fund. As a result, should insufficient funds be available for grants the Fund considers it appropriate to make, the Society could enforce its powers to raise a special levy contribution against regulated individuals and bodies to fund the shortfall in accumulated funds. This would, however, carry reputational risk with these groups and therefore would be an action of last resort. The risk of inappropriate grants being made is mitigated by a maintaining a robust process of investigation and adjudication.

Note 9 provides further details of claims open at the year end.

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<sup>1</sup> A copy of the SRA Compensation Fund Rules 2011 is available online at <http://www.sra.org.uk/solicitors/handbook/compfund>

### **Statement of financial control**

The Board acknowledges that it is responsible for the system of internal financial control and has reviewed its effectiveness, having regard to the following key procedures:

- a clearly defined management structure with open lines of communication;
- an on-going review by the Board of the cost of claims in relation to the income and assets of the Fund;
- approval of annual expenditure budgets;
- a monthly review of actual expenditure against budget;

All decisions and payments pertaining to the Fund and STAs are governed by the SRA's schedule of delegations which was approved by the Board in February 2009 and most recently updated in June 2015. The Board reviews the effectiveness of the internal financial processes with financial management representatives and Deloitte LLP, our outsourced provider of internal audit services.

It must be stated that a system of internal financial control can provide only reasonable and not absolute assurance against material misstatement or loss.

## **Statement of the Council of the Law Society and SRA Board's Responsibilities in respect of the financial statements**

### **Council of the Law Society**

The Council of the Law Society is accountable for the maintenance of the Fund due to its responsibilities in law.

The financial management of the Fund has been delegated by the Council to the Solicitors Regulation Authority (SRA) Board of the Law Society.

### **SRA Board**

Under delegated authority from the Council of the Law Society, the SRA Board is responsible for the preparation of the non –statutory financial statements in accordance with the basis of preparation and accounting policies in note 1 and which show the position of the Fund at the end of the financial year and of any surplus or deficit for that period.

The SRA Board has taken responsibility for preparing non-statutory financial statements although there is no specific legal requirement to do so. The Council and SRA Board must not approve the non-statutory financial statements unless they are satisfied that they have been properly prepared, in all material respects, in accordance with the basis of preparation and accounting policies in note 1 to the non-statutory financial statements.

In preparing these non-statutory financial statements, the SRA Board have:

- selected suitable accounting policies and then applied them consistently;
- made judgements and accounting estimates that are reasonable and prudent;
- stated the basis of preparation and accounting polices applied;
- prepared the non-statutory financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The SRA Board are responsible for keeping adequate accounting records that are sufficient to show and explain the Fund's transactions and disclose with reasonable accuracy at any time the financial position of the Fund. They are also responsible for safeguarding the assets of the Fund and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

**Statement of the Council of the Law Society and SRA Board's Responsibilities  
in respect of the financial statements (Continued)**

**Statement of disclosure of information to auditors**

In relation to Board members in office at the date the Board's report is approved, the following applies:

- so far as we are aware, members of the Board are not aware of relevant audit information that has not been disclosed to the Fund's auditors; and,
- appropriate governance arrangements are in place and are operated, such as by the activities of the SRA Finance & Resources Committee and the Business and Oversight Board;
- we and members of the Board are satisfied that, by the said governance arrangements, members of the Board have taken the steps that they ought to have taken as a member in order to make themselves aware of relevant audit information and to establish that systems and practices are in place so that the Fund's auditors are aware of that information.

Paul Philip  
CHIEF EXECUTIVE, SRA

Enid Rowlands  
CHAIR, SRA BOARD

Robert Bourns  
PRESIDENT OF THE LAW SOCIETY

Michael Garson  
TREASURER

Date:

## **Independent auditors' report to the Council of the Law Society**

### **Report on the financial statements**

#### **Our opinion**

In our opinion, the Compensation Fund's (the "Fund") financial statements (the "financial statements"):

- give a true and fair view of the state of the Fund's affairs as at 31 October 2015 and of its deficit for the year then ended; and
- have been properly prepared, in all material respects, in accordance with the basis of preparation and accounting policies in note 1 to the financial statements.

#### **Emphasis of matter - Basis of preparation**

In forming our opinion on the financial statements, which is not modified, we draw attention to the fact that the accounting policies used and disclosures made are not intended to, and do not, comply with the requirements of United Kingdom Generally Accepted Accounting Practice.

#### **What we have audited**

The financial statements, comprise of:

- the Balance sheet as at 31 October 2015;
- the Income and Expenditure account for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is the basis of preparation and accounting policies in note 1 to the financial statements.

In applying the financial reporting framework, the SRA Board has made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

### **Responsibilities for the financial statements and the audit**

#### **Our responsibilities and those of the Law Society Council and SRA Board**

As explained more fully in the Statement of Responsibilities set out on page 9, the Council of the Law Society has delegated responsibility for the financial management of the fund to the SRA Board. The SRA Board is responsible for the preparation of the financial statements in accordance with the basis of preparation and accounting policies in note 1 to the financial statements.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinion, has been prepared for and only for management's purposes to assist the Council of the Law Society to discharge its stewardship obligations and fiduciary responsibilities in respect of the Fund under the Bye-laws in our engagement letter dated **30 October 2015** and for no other purpose.

## **Independent auditors' report to the Council of the Law Society (continued)**

### **Our responsibilities and those of the Law Society Council and SRA Board (continued)**

We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, including without limitation under any contractual obligations of the Fund, save where expressly agreed by our prior consent in writing.

### **What an audit of financial statements involves**

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Fund's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the SRA Board; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the SRA Board's judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report and Financial Statements for the year ended 31 October 2015 to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

PricewaterhouseCoopers LLP  
Chartered Accountants  
London

**Income and expenditure account for the year ended 31 October 2015**

INCOME	NOTE	2015 £'000	2014 £'000
Contributions received in the current year	6	9,141	9,970
		<b>9,141</b>	<b>9,970</b>
Grant recoveries	7	7,009	6,437
Investment income received	3	111	230
Residual balances received from Statutory Trust accounts	7	622	1,785
<b>TOTAL INCOME</b>		<b>16,883</b>	<b>18,422</b>
<b>EXPENDITURE</b>			
Grants paid	2	(17,876)	(23,787)
Administration costs	5	(10,492)	(10,613)
Auditors' remuneration – audit fees		(23)	(23)
Income tax	4	(4)	(26)
<b>TOTAL EXPENDITURE</b>		<b>(28,395)</b>	<b>(34,449)</b>
<b>Deficit for the year</b>		<b>(11,512)</b>	<b>(16,027)</b>
Fund balance as at 1 November		<b>56,010</b>	<b>72,037</b>
Fund balance as at 31 October		<b>44,498</b>	<b>56,010</b>

All activities derive from continuing activities. The notes on pages 15-21 form part of these non-statutory financial statements.

**Balance sheet as at 31 October 2015**

	NOTE	October 2015 £'000	October 2014 £'000
<b>CURRENT ASSETS</b>			
Investments – cash funds		33,882	29,441
Bank and cash		5,856	33,224
Emergency funding debtors	8	-	600
Money owed from the Law Society	7	4,760	-
<b>TOTAL CURRENT ASSETS</b>		<b>44,498</b>	<b>63,265</b>
<b>CURRENT LIABILITIES</b>			
Amounts owed to the Law Society	7	-	(7,255)
<b>TOTAL CURRENT LIABILITIES</b>		<b>-</b>	<b>(7,255)</b>
<b>NET CURRENT ASSETS</b>		<b>44,498</b>	<b>56,010</b>
<b>ACCUMULATED FUNDS</b>		<b>44,498</b>	<b>56,010</b>

The notes on pages 15-21 form part of these non-statutory financial statements.

The financial statements of the Compensation Fund were approved on [xxxxx] by:

Paul Philip  
CHIEF EXECUTIVE, SRA

Enid Rowlands  
CHAIR, SRA BOARD

Robert Bourns  
PRESIDENT OF THE LAW SOCIETY

Michael Garson  
TREASURER

Date:

## Notes to the financial statements for the year ended 31 October 2015

### 1 Accounting policies

#### *Basis of preparation*

The financial statements have been prepared in accordance with the following accounting policies. As the Fund is maintained and administered pursuant to sections 36 and 36A of the Solicitors Act 1974 as amended by the Courts and Legal Services Act 1990 and under the provisions of the Administration of Justice Act 1985, it is not required to prepare statutory financial statements or comply with applicable United Kingdom accounting standards or the Companies Act 2006 but has chosen to prepare non-statutory financial statements and have them audited as good governance.

The accounting policies adopted by the Fund are described below and these have been applied consistently.

#### *Cash flow*

No separate cash flow statement is prepared as the accounting policies adopted by the Fund are predominantly on a cash accounting basis.

#### *Contributions*

Fund contributions received in conjunction with Society practising fees are recognised in full when an invoice is raised following an application from a solicitor or a firm. The contributions relate to practising years which begin on the 1 November each year. These amounts are recognised in full and not deferred and therefore the financial statements include amounts invoiced in advance relating to the following year.

#### *Grants paid*

Grants paid by the Fund are discretionary in nature and are accounted for when paid. Grant authorisation is given by an adjudication panel or an authorised adjudicator under delegated authority from the Board.

#### *Grants recovered via right of subrogation from the STAs*

The Fund is able to recover from the STAs, via right of subrogation, grants it has made provided certain procedures are followed. Recoveries from the STAs are recognised when cash is received.

#### *Grants recovered from solicitors*

The Fund is able to recover from solicitors, grants that have been paid out to former clients of those solicitors. Recoveries from solicitors are recognised when cash is received.

## Notes to the financial statements for the year ended 31 October 2015 (continued)

### 1 Accounting policies (continued)

#### *Residual balances received from Statutory Trust Accounts*

Remaining funds held in Statutory Trust Accounts are transferred to the Fund once all reasonable efforts to establish and trace beneficiaries have been exhausted. Income from residual balances in Statutory Trust Accounts is recognised when the cash is received.

#### *Investment income*

Investment income is received monthly in the form of dividends and interest. Income arising on bank and cash amounts is received as interest. Investment income is accounted for when cash is received.

#### *Administration costs*

Administration costs are incurred by the Fund via a recharge from the Society in accordance with agreed cost allocation methodology and cost allocation rates. Administration costs are recognised when actually calculated and notified to the Fund by the Society.

Certain costs are incurred directly by the Fund and are recognised when paid.

#### *Taxation*

The Fund is only liable to taxation on its investment income at the basic rate and normal dividend rates of income tax and obtains no tax relief for its overhead expenditure. Charges for taxation are recognised when paid or received and no account is taken of deferred taxation assets and liabilities.

#### *Valuation of investments*

Investments, constituting managed cash funds, are valued at their mid-market value at the Balance Sheet date on a portfolio basis. Given the cash nature of investments, except in exceptional circumstances, the mid-market value of investments is £1 for £1. Should any movements in mid-market value occur they shall be recognised through the income and expenditure account.

Of the investments £25m (2014: nil) are under fixed term cash deposit and recoverable in March 2016 with the remainder available for withdrawal with no more than seven days notice.

**Notes to the financial statements for the year ended 31 October 2015  
(continued)**

**1 Accounting policies (continued)**

*Going concern*

The level of reserves coupled with the fact that the Fund's grants are discretionary means the Board believe the Fund has sufficient funds available to it to meet future obligations as they fall due. The Society also has the power to raise an additional levy on regulated individuals and bodies between the annual collections if required. The Fund is therefore considered a going concern.

**2 Grants paid**

Grants paid in 2015 totalled £17.9m (2014: £23.8m).

**3 Investment income received**

	<b>2015</b>	<b>2014</b>
	<b>£'000</b>	<b>£'000</b>
Dividends	55	84
Interest	56	146
	<u>111</u>	<u>230</u>

**4 Income tax**

Income tax is payable on gross dividends and interest earned during the year from money market funds and treasury deposits. Income tax falling due on investment income for the financial year totals £23k (2014: £46k).

On a paid and received basis and as reported in the income and expenditure account, £4k of income tax was paid this year (2014: £26k).

**Notes to the financial statements for the year ended 31 October 2015  
(continued)**

**5 Administration Costs**

	<b>2015 £'000</b>	<b>2014 £'000</b>
Direct cost of processing Compensation Fund claims	1,506	1,143
Direct cost of intervention and other legal costs	<u>6,601</u>	<u>6,359</u>
<b>TOTAL DIRECT COST</b>	<u>8,107</u>	<u>7,502</u>
Allocated cost of other regulatory activity that administers and protects the Fund	<u>567</u>	<u>1,293</u>
<b>TOTAL ALLOCATED COST</b>	<u>567</u>	<u>1,293</u>
Contribution to premises costs and other central overheads:		
Central costs contribution	<u>1,817</u>	<u>1,816</u>
<b>TOTAL CONTRIBUTION COST</b>	<u>1,817</u>	<u>1,816</u>
<b>TOTAL ADMINISTRATION COSTS</b>		
Recharged from the Society	10,491	10,611
Bank charges	<u>1</u>	<u>2</u>
<b>TOTAL ADMINISTRATION COSTS</b>	<u><u>10,492</u></u>	<u><u>10,613</u></u>

## **Notes to the financial statements for the year ended 31 October 2015 (continued)**

### **6 Compensation Fund contributions**

Contributions recognised in 2015 totaled £9.1m (2014: £10m) of which £6.5m (2014: £6.1m) related to the practicing year 2015/16. Of the budgeted £8.5m for the 2015/16 practicing year (2014: £8.5m) a further £2m (2014: £2.3m) had been invoiced by the end of January 2016.

### **7 Related party transactions**

The Society has ultimate accountability for the maintenance of the Fund and the STA's. Both the Society and the STA's are therefore considered to be related parties for the purpose of financial reporting.

The Society collects all Fund contributions on behalf of the Fund, as disclosed within the income and expenditure account. In addition the Society charges the Fund administration costs, as disclosed in note 5. Amounts due from the Society at 31 October 2015 are £4.8m (2014: due to the Society £7.3m) and are disclosed within the balance sheet.

Transactions with the STAs are recovery of grants under rights of subrogation and amounted to £7m (2014: £6.4m).

Further monies are also received from residual balances in STAs once all reasonable efforts have been made to trace beneficiaries. Any remaining funds are then transferred to the Fund and amounted to £0.6m in 2015 (2014: £1.8m).

Disclosure of related parties arising from Council members and Board members, included in recharged costs, are disclosed in the Society consolidated financial statements.

There are no other significant related party transactions.

### **8 Emergency funding debtors**

Emergency funding is provided to agents appointed by the SRA to complete transactions due at the time of intervention, as the intervened solicitors' funds will have been frozen.

As at 31 October 2015 there were no emergency funding balances outstanding from agents (2014: £600k re-paid November 2014).

**Notes to the financial statements for the year ended 31 October 2015  
(continued)**

**9. Disclosure of significant assets and liabilities**

Due to the predominantly cash accounting nature of the accounting policies certain assets and liabilities are not included in the financial statements. The most significant are explained below.

*Claims open*

As explained in note 1, grants made are recognised when cash is paid. Amounts approved for payment and those related to outstanding claims being investigated are not included in the financial statements.

As at 31 October 2015, claims open, totalled £36.8m (2014: £43.8m) which is the total originally notified value of claims at the year end.

We have estimated the grants that may result from the claims outstanding at the end of 2015 and consider that the balances in the Fund are more than sufficient to meet this potential liability.

During 2015 claims with a value of £87.3m (2014: £70.9m) were received or reopened and claims with a value of £93.6 were closed or deleted (2014: £108.4m) resulting in grants of £17.9m in relation to those claims (2014: £23.8m).

The value of a claim is reported for the financial statements as the original notified claim amount. Where the originally notified claim is amended during the year on open claims these revaluations are included in net change in value of open claims, the net effect of these revaluations was a decrease of £0.7m in the value of claims open in 2014 (2013: decrease £3.8m).

The movement in the value of claims open during 2015 and 2014 is shown in the table below.

	<b>2015</b>	<b>2014</b>
	<b>£'m</b>	<b>£'m</b>
Claims open at 1 November	43.8	85.1
Claims closed or deleted during the year	(93.6)	(108.4)
Net change in value of open claims	(0.7)	(3.8)
Claims received or reopened during the year	87.3	70.9
Claims open at 31 October	<b>36.8</b>	<b>43.8</b>

**Notes to the financial statements for the year ended 31 October 2015  
(continued)**

**9 Disclosure of significant assets and liabilities (continued)**

No estimate can currently be made of future claims against interventions in progress and no estimate is made of amounts recoverable from the seized accounts relating to those interventions.

*Statutory Trust Accounts, undistributed balances*

The 2006 Re Ahmed judgment provided for any undistributed STA balances (residual balances) to be transferred to the Fund after reasonable investigations to distribute them.

In 2015 this resulted in £0.6m being transferred from STAs to the Fund (2014: £1.8m). This is in addition to the funds received via rights of subrogation. The SRA is continuing to identify historic undistributed balances which can be transferred to the Fund.

*Statutory Trust Accounts, amounts due via right of subrogation*

In accordance with the accounting policies, no amounts are recognised within the balance sheet or income and expenditure account in respect of amounts due to the Fund via rights of subrogation from the STAs as these amounts are only recognised when paid.

Whilst the amounts due to the Fund are likely to be significant we are currently unable to accurately quantify the amount due. At the end of October 2015 the total balance held in STAs was £22.3m (2014: £15.0m).

*Uninsured Firms*

From 1 October 2012 the SRA Compensation Fund Rules were changed to provide cover for claims made against uninsured firms that would previously have been covered by the Assigned Risks Pool (ARP) under the arrangements for non-applied firms. This cover is similar to that provided historically through the ARP arrangements whilst still retaining the discretionary nature of the Compensation Fund. The cover extends to claims made against firms that are practising whilst uninsured and includes six year run-off cover in the event that a practice ceases without successor practice whilst uninsured.

**SRA Board**  
13 September 2016

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**PricewaterhouseCoopers LLP**

1 Embankment Place  
London  
WC2N 6RH

Attention: Julian Jenkins

Dear Sirs

**2015 Compensation Fund Letter of Representation**

This representation letter is provided in connection with your audit of the financial statements of The Compensation Fund (the “Fund”) for the year ended 31 October 2015 for the purpose of expressing an opinion as to whether the financial statements of the Fund have been prepared in accordance with the basis set out in note 1 to the accounts, including the financial position as at 31 October 2015, and the surplus of income over expenditure for the year then ended.

As outlined in the Statement of Responsibilities the Council of the Law Society is accountable for the maintenance of the Fund due to its responsibilities in law. The financial management of the Fund has been delegated by the Council to the Solicitors Regulation Authority (SRA) Board of the Law Society.

The SRA Board has taken responsibility for preparing financial statements although there is no specific legal requirement to do so.

The SRA Board acknowledges responsibility for preparing financial statements of the Fund which are in accordance with the accounting policies and for making accurate representations to you.

We confirm that the following representations are made on the basis of enquiries of management and staff of the Fund with relevant knowledge and experience and, where appropriate, of inspection of supporting documentation sufficient to satisfy ourselves that we can properly make each of the following representations to you.

We confirm, on behalf of all members of the SRA Board, to the best of our knowledge and belief, and having made the appropriate enquiries, the following representations:

***Financial statements***

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement letter dated **30 October 2015**, for the preparation of the financial statements in accordance with the chosen accounting policies for the year ended 31 October 2015.
- All transactions have been recorded in the accounting records and are reflected in the financial statements.
- Significant assumptions used by us in making accounting estimates are reasonable.
- All events subsequent to the date of the financial statements have been adjusted or disclosed.
- There are no uncorrected misstatements, both individually and in the aggregate, to the financial statements as a whole.
- The financial statements disclose all matters of which we are aware that are relevant to the Fund’s ability to continue as a going concern, including all significant conditions and events,

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mitigating factors and the Fund's plans. The Fund also has the intent and ability to take actions necessary to continue as a going concern.

Specifically we confirm that we have considered the outstanding claims the Fund has been notified of and, despite the significant value, we do not expect we will pay out a large proportion of the claims value and therefore we consider that the Fund retains sufficient reserves to meet the liabilities of the claims we are aware of. Ultimately we could request further funding from the profession should claims arise that we do not have reserves to meet, or delay payment of grants. However we do not envisage this occurring.

***Information Provided***

In relation to SRA Board members in office at the date the Board's report is approved, the following applies:

- so far as we are aware, members of the SRA Board are not aware of relevant audit information that has not been disclosed to the Fund's auditors; and,
- appropriate governance arrangements are in place and are operated through the activities of the SRA Finance & Resources Committee, the Law Society Audit Committee and the Business and Oversight Board;
- we and members of the SRA Board are satisfied that, by the said governance arrangements, members of the SRA Board have taken the steps that they ought to have taken as a member in order to make themselves aware of relevant audit information and to establish that systems and practices are in place so that the Fund's auditors are aware of that information.
- We have provided you with:
  - Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
  - Additional information that you have requested from us for the purpose of the audit; and
  - Unrestricted access to persons within the Fund from whom you determined it necessary to obtain audit evidence.

***Fraud and non-compliance with laws and regulations***

- We acknowledge our responsibility for the maintenance of internal control to prevent and detect fraud.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the Fund and involves:
  - Management;
  - Employees who have significant roles in internal control; or
  - Others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the Fund's financial statements communicated by employees, former employees, analysts, regulators or others.
- We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.

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***Related party transactions***

We confirm that the ultimate controlling party is the Council of the Law Society. The Council of the Law Society has ultimate accountability for the maintenance of the Fund and, governing powers from responsibilities in law.

We confirm that the attached appendix to this letter is a complete list of the Fund's related parties. All transfer of resources, services or obligations between the Fund and these parties have been disclosed to you, regardless of whether a price is charged. We are unaware of any other related parties, or transactions between disclosed related parties.

***Employee Benefits***

We confirm that we have made you aware of all employee benefit schemes in which employees of the company participate. Although overall governance is maintained by the Council, the day to day operational decisions and therefore these responsibilities are delegated under authority to the SRA Board as explained in the Statement of responsibilities.

***Contractual arrangements/agreements***

All contractual arrangements (including side-letters to agreements) entered into by the Fund have been properly reflected in the accounting records or, where material (or potentially material) to the financial statements, have been disclosed to you.

***Litigation and claims***

We have disclosed to you all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements and such matters have been appropriately accounted for and disclosed in accordance with the chosen accounting policies.

***Taxation***

We have complied with the taxation requirements of all countries within which we operate and have brought to account all liabilities for taxation due to the relevant tax authorities whether in respect of any corporation or other direct tax or any indirect taxes. We are not aware of any non-compliance that would give rise to additional liabilities by way of penalty or interest and we have made full disclosure regarding any Revenue Authority queries or investigations that we are aware of or that are ongoing.

**Specific representations relating to the Fund**

**Compensation Fund recharge**

- The amounts recharged to the Fund of £10.4m (2014 £10.6m) are calculated on the basis advised by leading counsel. Whilst the agreement for allocating the aforementioned costs allows some flexibility in the amounts recharged, we believe that the percentages allocated are appropriate and reflective of the share of costs incurred in relation to Fund's business. We confirm that all of the underlying percentage allocations included in the calculations are a fair reflection of the elements relevant to the Fund's operations and these changes reflect the evolving nature of the interaction between the two entities.

**Unrecognised assets and liabilities disclosures**

- We confirm that the disclosures made in relation to the unrecognised assets and liabilities represent management's best estimates and therefore we are satisfied that the disclosures made in note 9 to the accounts are fair reflection of the position with respect to these. We do not believe it is necessary to include any other assets or liabilities.

**Axiom**

- We confirm that no liability is expected to arise with regards to Axiom litigation case.

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13 September 2016

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As minuted by the following representatives on [date]

Paul Philip  
(Chief Executive SRA Board)

Matthew Robinson  
(Head of Financial Accounting)

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13 September 2016

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**Appendix A –List of related parties**

Solicitors Indemnity Fund  
Solicitors Indemnity Fund Limited  
Legal Indemnity Operations Limited  
Legal Practice Technologies Limited  
Six Clerks Insurance Services Limited (trading as Chancery PII)  
Riliance Software Limited  
Queens Counsel Appointments Limited  
The Compensation Fund  
The Law Society Services Limited  
The Law Society Educational Trust  
The Law Society Charity  
The Law Society Trustees Limited  
The Law Society Pension Fund  
The Council members of the Law Society  
Members of the management board of the Law Society  
Members of the SRA board  
Members of the Audit Committee of the Law Society  
Members of the Remuneration Committee of the Law Society  
Global Law Summit Limited  
Assigned Risk Pool  
Statutory Trust Accounts