

**REPORT BY THE COMPTROLLER AND AUDITOR
GENERAL TO THE HOUSES OF PARLIAMENT**

**COMMUNITY LEGAL SERVICE FUND AND CRIMINAL DEFENCE
SERVICE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2011**

Report of the Comptroller and Auditor General to the Houses of Parliament on the Community Legal Service Fund and Criminal Defence Service Accounts for the year ended 31 March 2011

Introduction

1. The Legal Services Commission (the Commission) is an executive Non Departmental Public Body (NDPB) of the Ministry of Justice. The Commission is responsible for the provision of legal aid in England and Wales through the Community Legal Service Fund (for civil cases) and the Criminal Defence Service (for criminal cases).

The purpose of my report

2. The purpose of this Report is to explain the background to the qualifications of my audit opinions on the Community Legal Service Fund and Criminal Defence Service accounts for the year ended 31 March 2011.

My obligations as Auditor

3. Under the Access to Justice Act 1999, I am required to examine, certify and report on the Commission's accounts. I am required, under International Standards on Auditing (UK and Ireland) to obtain evidence to give reasonable assurance that these accounts are free from material misstatement. In forming my opinion, I examine evidence supporting the disclosures in the financial statements and assess the significant estimates and judgements made in preparing them. I also consider whether the accounting policies are appropriate, consistently applied and adequately disclosed.
4. In addition, I am required to satisfy myself that the expenditure and income shown in the accounts have been applied to the purposes intended by Parliament and conform to the authorities that govern them; that is, they are "regular". In determining whether expenditure and income conforms to the authorities that govern them, I have regard to the legislation authorising the financial transactions and relevant regulations issued under the governing legislation.

Audit opinions

5. In 2010-11, I have qualified my audit opinion due to material irregularities in respect of legal aid payments made to providers (the **regularity qualification**). This qualification is on the same basis as reported in 2009-10.
6. I have also found it necessary to limit the scope of my opinion in respect of the valuation of the receivables balance reported in Note 8 of these accounts and the related movement in the impairment provision reported in Note 3 (the

receivables qualification). The Commission has been unable to provide sufficient evidence to support the value of the recorded receivables.

Qualified audit opinion due to material irregular payments to legal aid providers

7. I have qualified my opinion on the Commission's accounts for the year ended 31 March 2011 as I identified material irregularities in respect of payments made to legal aid providers. In order to support my regularity opinion, I needed to assure myself that the amounts paid to legal aid providers were in line with the legislation governing the fee regimes, that the Commission approved legal aid only to applicants who were eligible, and that the correct level of contributions were levied on clients. My testing identified an estimated total error of £50.7 million on expenditure. This represents 2.2 per cent of the Commission's expenditure during the year.
8. The irregular expenditure relates to:
 - inaccurate claims paid to legal aid providers not in compliance with the statutory fee regimes of £29.5 million (the **payment accuracy errors**); and
 - payments of legal aid via providers to applicants who were not eligible or whose eligibility could not be proven of £21.2 million (the **eligibility errors**).
9. My regularity opinion is based on an estimated total error, which is extrapolated from errors identified through sample testing. Therefore it is not possible to trace the total error to individual transactions, and whilst the Commission does seek to recover incorrect payments identified through its assurance work, recoveries are not expected to amount to the total extrapolated error.
10. I qualified my regularity opinion on the Commission's 2009-10 accounts¹ based on an estimated error of £76.5 million on legal aid expenditure. The total estimated error on expenditure has reduced by 34 per cent during 2010-11.
11. My 2009-10 report also noted an estimated net £2.1 million of income contributions which should not have been levied by the Commission. The level of error in income has increased in 2010-11, particularly for contributions that were not levied by the Commission when they should have been, which have increased from £2.5 million to £9.1 million. Whilst the error has increased, it is not material and therefore I have not qualified my opinion in this respect.

Progress since my last report

¹ Report of the Comptroller & Auditor General to the Houses of Parliament on the Community Legal Service Fund and Criminal Defence Service Accounts for the year ended 31 March 2010, HC 575, 2009-10.

12. The Accounting Officer's Statement on Internal Control² provides a comprehensive account of the internal control issues facing the Commission, outlining progress made against them and further work to be done.
13. The Commission has made significant improvements in the level of total irregular expenditure reported in 2010-11. The key areas of improvement are as follows.
- On the Crime Lower scheme, the extrapolated error on accuracy of payments to providers has fallen from £23.5 million in 2009-10 to £1.5 million in 2010-11.
 - On eligibility for the Legal Help scheme, the extrapolated error has fallen from £9.1 million in 2009-10 to £1.9 million in 2010-11.
14. These improvements are due to the Commission's increased focus on higher risk areas, enhanced audit testing and provision of additional clarity and guidance to providers.
15. There are some areas where the level of error has not significantly changed, or has increased. It is therefore important that the Commission continues to quantify and monitor the level of error across all streams of income and expenditure, so that appropriate action can be taken where risk or error remains high.

Payment accuracy errors

16. During my audit I have estimated £29.5 million of overpayments to legal aid providers, as set out in the following table.

ESTIMATED ERROR ON ACCURACY OF PAYMENTS				
Legal Aid Scheme	2010-11		2009-10	
	Population* £'m	Error Rate %	Estimated Total Error £'m	Estimated Total Error £'m
<u>CIVIL</u>				
Legal Help: Immigration and Family	109.0	14.1	15.4	15.7
Legal Help: Other	95.5	3.1	3.0	0.5
Civil Representation: Bills and Mediation	1,116.1	0.3	3.3	0.3
Civil Representation: Very High Cost Cases (VHCC) payments	113.7	3.2	3.6	2.0
<u>CRIME</u>				
Crime Lower: Police Station and Magistrates' Court claims	460.5	0.3	1.5	23.4
Crime Higher: Crown Court payments to advocates and solicitors	610.9	0.4	2.5	0.7

² Legal Services Commission Annual Report and Accounts 2010-11, HC 1555 page 34.

Crime Higher: Very High Cost Cases (VHCC) payments	93.1	0.2	0.2	1.0
Total of Accuracy Errors			29.5	43.6

* The populations shown are cash payments in the year

17. I have outlined below further details of the most significant errors and movements.

Legal Help and Crime Lower

18. Due to the high volume and low value of claims made under the Legal Help and Crime Lower schemes, the Commission does not validate amounts claimed by individual providers before payment is made. Instead, throughout the year, the Commission reviews a sample of claims to confirm whether suppliers have met contractual requirements, and that claims are supported by sufficient evidence.

19. For my 2009-10 audit I was unable to rely on the assurance work conducted by the Commission. However, for 2010-11, I was able to place reliance on the majority of this work. Quality control of the Commission's assurance process has significantly improved, and I was able to confirm that the process was identifying errors and treating them consistently.

20. The Commission's testing of the Crime Lower scheme identified a significant decrease in the error rate. In 2009-10 a large number of claims for Police Station Attendance were found to be out of scope as they had not been routed through the Defence Solicitor Call Centre (DSCC). While everyone is eligible to receive legal aid funded advice at a police station, the DSCC provides authorisation to the solicitor to give advice to the client. Further guidance has been provided to suppliers which has contributed to the reduced error rate in 2010-11.

21. The Commission's testing of payments made under the Legal Help scheme identified an increase in the error rate. As in 2009-10, the highest level of financial error was in relation to Family and Immigration claims. The testing performed indicated that 14 per cent (2009-10: 12 per cent) of all Family and Immigration claims were incorrect or not fully supported.

22. As in 2009-10, the errors in relation to the Family scheme largely relate to the distinction between level 1 and level 2 fees, with providers claiming the higher level 2 fee when the criteria had not been met.

23. The error on the Immigration scheme has increased from £6.8 million to £8.7 million. This increase is due largely to additional errors relating to claims made by a significant provider who went into administration in May 2010. There was a lack of sufficient evidence to support the accuracy of several claims as files

could not be presented for audit. These errors totalled £2.0 million, with the remaining £6.7 million relating principally to errors on hourly rates claimed on standard immigration cases.

24. My previous reports identified the complexity of the Commission’s fee schemes as a major contributory factor toward the relatively high level of error in claims under both the Legal Help and Crime Lower schemes. This remains a significant issue for all Civil and Crime schemes, including Legal Help and Crime Lower.

Eligibility errors

25. I have identified an estimated £21.2 million of payments made via providers to clients who were not eligible for legal aid, or whose eligibility could not be proven as set out in the following table.

ESTIMATED ERROR ON ELIGIBILITY				
Legal Aid Scheme	2010-11			2009-10
	Population*	Error Rate	Estimated Total Error	Estimated Total Error
	£'m	%	£'m	£'m
Legal Help	188.5	1.0	1.9	9.1
Crime Lower: Magistrates' Court	122.5	0.9	1.1	0.3
Civil Representation	146.1	12.4	18.2	23.5
Total of Eligibility Errors			21.2	32.9

* The populations shown are cash payments in the year

26. I have outlined below further details of the most significant errors and movements.

Legal Help

27. The means assessment to determine financial eligibility for the legal help scheme is carried out by the legal aid provider, before providing advice to clients on a civil matter.
28. Testing conducted by the Commission includes confirming an individual’s eligibility for the receipt of legal aid through review of additional and alternative sources of evidence. I was able to place reliance on the results of this work for my audit.
29. The Commission identified an estimated error of £1.9 million from this exercise, which has decreased substantially from the previous year. There has been an increased focus on eligibility by the Commission and the introduction of a ‘Legal Help Enquiry’ line in January 2010 provided a central point of contact for provider queries. The enquiry line receives approximately 850 calls per month, of which 40 per cent are typically queries on financial eligibility.

Civil Representation

30. For Civil Representation, the Commission must assess an individual's eligibility for legal aid before a solicitor can represent a client at the County or Family Court.
31. As in 2009-10, the Commission undertook an assurance exercise to test the eligibility of funded clients, based on their initial means assessment and through review of additional and alternative sources of evidence. I was able to place reliance on the Commission's work for my audit.
32. The Commission identified an estimated error of £18.2 million from this exercise (based on a 12.4 per cent error rate), which indicates that the Commission may have paid this amount to providers for representation of individuals in court who were not eligible for legal aid. The extrapolated error of £18.2 million has decreased from 2009-10. As the error rate has remained relatively consistent, this reduction is due to lower cash expenditure on Civil Representation during 2010-11.
33. The Commission has taken significant steps to enhance its controls in this area. This has not yet had a significant impact on the reported error rate because Civil Representation cases have an average life of two years from the date a legal aid certificate is granted to receipt of the final bill. As my regularity opinion relates to cash paid in 2010-11, this predominantly relates to certificates granted in previous years. The enhanced controls will therefore take some time to fully impact the regularity of cash payments made by the Commission.

Income errors

34. The Commission received contributions of £11.4 million during the year from clients funded for Civil Representation. The eligibility testing described above also identified regularity errors in relation to this income. The Commission identified an estimated error of £4.9 million (2009-10: £4.5 million) in relation to contributions paid by clients that should not have been levied by the Commission and an estimated error of £9.1 million (2009-10: £2.5 million) in relation to contributions that were not levied by the Commission where clients should have been required to pay them. Income received by the Commission, to which it is not entitled is irregular. Similarly, income which the Commission should have levied and recovered, but did not, is also irregular. Both errors can arise due to errors in the determination of an individual's eligibility or calculation errors by the Commission.
35. My assessment of the income error is based on a sample of applicants' contributions, so it is not practical for the Commission to use this as a basis for making specific repayments of incorrect contributions to funded clients.

Developments in systems and controls since my last report

36. My previous Reports have identified a number of areas where action was required to improve the control environment. The significant control weaknesses, and the actions taken to target these, are explained in the Accounting Officer's Statement on Internal Control.
37. The key developments since my previous report can be summarised as:
- identifying and managing areas of risk;
 - improvements to internal processes and systems; and
 - working with providers and recovering overpayments

Identifying and managing areas of risk

38. Following my Report on the Commission's 2009-10 accounts, considerable work was undertaken to review and categorise the areas of expenditure contributing to the total regularity error. The Commission sought to analyse the causes of errors across all legal aid schemes, to enable it to take appropriate action. Internal assurance work has continued in 2010-11, and the Commission now has a better understanding of the areas of risk that contribute to the errors. During 2011-12, the Commission started testing on a monthly basis, so that it has a more timely understanding of trends in error rates as the year progresses.
39. The Commission's Counter-Fraud Strategy was developed in 2010-11 to improve the identification of the risks of fraud. Thematic investigations are currently being undertaken in five areas of potential fraud risk, and the Commission is increasing its capability by working more closely with stakeholders, such as the Department for Work and Pensions (DWP).

Improvements to internal processes and systems

40. The Commission has improved its internal quality assurance testing to reduce processing errors by staff. Monthly cross-office quality control reviews are undertaken on merits testing, means assessments and payment of final bills. In addition, the Commission has implemented improvements to its systems to reduce the scope for error; for example introducing controls that prevent the input of incorrect codes and amounts in the online submissions for Crime Lower payments.
41. The Commission has enhanced the means assessment process for Civil Representation. From December 2010, it has been mandatory for all applicants to provide bank statements to support their means assessments. This has subsequently been revised to include wage slips and mortgage statements. The Commission is continuing to review its eligibility assessment processes for civil representation cases with a view to further strengthening the control framework.

Working with providers and recovering overpayments

42. The Commission introduced a new Provider Management Strategy in 2010-11 to profile provider risk, target areas of greatest concern and improve provider performance. The Commission has informed me that it has undertaken over 2,900 provider visits during 2010-11, including some detailed on-site audits. As a result of these, the Commission has issued a number of contract notices to providers and terminated some provider contracts. The Commission has found that where a contract notice has been issued and a subsequent follow-up visit made, the majority of providers visited had resolved the issue identified.
43. The Commission has worked with providers to identify areas at risk of errors. This has led to issuance of additional guidance to support providers during the year, such as clarification of the requirements for Defence Solicitor Call Centre authorisation.
44. The additional work undertaken by the Commission has led to the identification and recovery of substantial overpayments to suppliers. This work is ongoing, but recoveries of £7.1 million (2009-10: £4.6 million) have been made during the year.

Further steps planned and required by the Commission

45. The Commission should continue to monitor the level of error arising as a result of both:
 - inaccurate claims paid to providers outside of the statutory fee regimes;
 - and
 - payments of legal aid via providers to applicants whose eligibility cannot be proven as supporting information is inaccurate or incomplete.
46. The Commission has moved to monthly testing of the accuracy of claims. This will enable the Commission to have a more timely understanding of trends in the error rates as the year progresses and to respond more rapidly to any emerging risk areas either by issuing additional guidance or performing more focused testing.
47. The Commission should also continue to use the results of its assurance work to further develop its understanding of the high-risk areas and design suitable preventative controls to get it right first time.

Qualified opinion on the financial statements due to a limitation of scope on the receivables balance

48. My audit opinion includes a statement on whether the financial statements give a true and fair view of the state of the Community Legal Service Fund and the Criminal Defence Service's affairs as at 31 March 2011 and of its net expenditure for the year then ended. I have limited the scope of my opinion on the valuation of the receivables balance at 31 March 2011 and the related movement in the impairment provision recognised in Note 3.
49. My testing has shown that the Commission's model estimating the value of receivables contains material errors in the input data. There is also a lack of evidence supporting the assumptions used to estimate the impaired receivables balance. Consequently, I have not obtained sufficient, appropriate audit evidence to support the valuation of the receivables balance of £153.2 million and the movement in the impairment provision of £43.7 million charged to the Statement of Comprehensive Net Expenditure.

Basis for qualified opinion on receivables

50. The Commission's accounts disclose a receivables balance of £153.2 million in the Statement of Financial Position. This is calculated from a gross receivables balance of £294.4 million, which is then impaired. The impairment provision of £141.2 million represents 48 per cent of the gross receivables balance. This reflects the Commission's assessment of the recoverability of the debts it holds at the year-end, based on historic cash receipts against previous years' receivables. This assessment is a significant accounting estimate and is not based on assessments at an individual case level as this would not be practical due to the high number of items included within the balance.
51. The Commission continues to pursue all debts irrespective of the impairment until a business decision is made that an individual debt is irrecoverable, at which point it is written-off. Debts totalling £23.1 million were written-off during the year.
52. The majority of the Commission's receivables are due from clients who have benefited from legal aid, and are expected to repay part of the costs of their legal aid. This is known as the 'statutory charge' where the Commission has the rights over any monies or property awarded as a result of the legal case. Repayment of these debts can be deferred, subject to the Commission registering its security and charging interest, which means some receivables will not be repaid for a number of years.

Errors within the gross receivables balance

53. I performed testing on a sample of debts selected from the gross receivables balance. Testing identified a significant level of error, indicating a £50.4 million overstatement when extrapolated.
54. The types of errors identified included:
- errors in the underlying data for individual debts;
 - failure of interfaces between the systems used to manage and record debt;
 - instances where action was not taken at the appropriate time to enable the debts to be recovered; and
 - lack of evidence to support the existence or valuation of the debt.
55. The Accounting Officer's Statement on Internal Control³ explains that the errors found in the receivables balance are largely due to limitations in legacy IT systems which create difficulties in reporting and managing the receivables due. The long life of some debts also means errors accumulate over time. My audit testing identified a higher level of error than was found in 2009-10, which is due partly to the accumulation of errors and partly from a better understanding of the risks underlying the receivables balance.

The impairment model

56. I also performed testing on the model used by the Commission to estimate the level of impairment of receivables.
57. The model uses 11 years of historic cash receipts data to forecast the cash receipts expected over the next 11 years from the gross receivables balance. The current model was used for the first time in 2009-10. In accordance with International Standard on Auditing 540: *Auditing Accounting Estimates*, I compared the 2009-10 model's predicted cash receipts with the cash actually received in 2010-11. This comparison suggested that the 2009-10 model had over-estimated cash receipts in 2010-11 by 31.7 per cent or £11.6 million.
58. The Commission investigated whether the results for the 2009-10 model were representative by 'rolling back' the model to establish the results it would have predicted for 2008-09 and 2007-08. These results were compared with the actual cash receipts, and were similarly inaccurate. These results indicate a lack of satisfactory evidence supporting the assumptions within the impairment model.

Further steps planned and required by the Commission

59. During the year the Commission undertook review and testing of the receivables balance, which has significantly improved its understanding of the underlying issues. The Commission is moving towards implementing a new IT system, which

³ Legal Services Commission Annual Report and Accounts 2010-11, HC 1555 page 34.

will have both operational and financial reporting facilities. This should provide more accurate and complete management information. The receivables balance will be reviewed and substantially cleansed during the implementation of, and transition to, the new system. The Commission currently has over 90,000 cases with outstanding receivables balances, so this cleansing process is likely to take some time.

60. The Commission has a responsibility to collect income on behalf of the Exchequer, but it must also fulfil its financial reporting responsibilities to determine an accurate valuation of the net receivables balance at year-end. In order to achieve this, the Commission needs sufficient information about the recoverability of its receivables. For example, the Commission is currently not able to age its debts and therefore cannot monitor recovery in this way. This and additional information will be essential once receivables are transferred into the new IT system, because historic recovery data will not be relevant for impairing the 'cleansed' receivables balance.

Conclusions

61. The Commission has made substantial improvements to the level of irregular payments made to legal aid providers, but there is still scope for further progress. The Commission faces significant challenges to reduce the level of extrapolated error in an environment of resource constraint across the Ministry of Justice. The most substantial barriers to improvement in this area arise from the inherent difficulties in administering a means-tested system of entitlement, and from the complexity of the fee schemes paid under legal aid. In addition, the Commission is continuing to seek opportunities for significant cost reductions over the coming years in order to achieve its Spending Review settlement. The Commission will therefore need to make difficult decisions on the costs and benefits of further work to reduce the level of irregularity.
62. In respect of its receivables balance, the Commission must address substantial inaccuracies in the book value of its receivables, which will allow it to more accurately estimate the fair value of that balance. As the Commission moves towards implementing its new IT solution, it is essential that these activities are completed before individual debtors are recorded on the new system.
63. My audit of the Commission's financial statements for 2011-12 will again examine the level of irregular transactions. In addition, I will look for improvements in the quality of data the Commission can provide to support the receivables balance. I will report on the progress that the Commission makes in addressing both issues.

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24 October 2011**

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