
**Legal Services Commission, Community Legal Service Fund and
Criminal Defence Service 2011-12 Accounts**

**Report by the Comptroller and Audit
General**

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 2012

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 qualification of my audit opinion on the Community Legal Service Fund and Criminal Defence Service accounts for the year ended 31 March 2012.

Audit opinions

3. I have qualified my opinion on regularity due to material irregularity in respect of legal aid payments made to providers (the **regularity qualification**) for the financial year ending 31 March 2012. This qualification is on the same basis as reported in 2010-11 and previous years. I have issued an unqualified opinion on the financial statements (the **true and fair opinion**).

Qualified audit opinion on regularity due to material errors in payments to legal aid providers

4. I have qualified my regularity opinion on the Commission's accounts for the year ended 31 March 2012 as I identified a material level of payments made to legal aid providers which were not in accordance with legislation and other authorities. 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 towards legal aid costs was levied on the Commission's clients.
5. My testing identified a net estimated total irregularity of £35.6 million on expenditure. This represents 1.7 per cent of the Commission's expenditure during the year.
6. The irregular expenditure relates to:

- amounts paid to legal aid providers where the claim was not in compliance with the statutory fee regimes of £20.4 million (the **payment irregularities**); and
 - payments of legal aid via providers to applicants who were not eligible or whose eligibility could not be proven of £15.2 million (the **eligibility irregularities**).
7. My regularity opinion is based on an estimated total irregularity, which is extrapolated from errors identified through sample testing and net of recoveries made during the year. Consequently, it is not possible to trace the total irregularity to individual transactions.
 8. The total estimated irregularity has fallen by 28 per cent since the prior year when I qualified my regularity opinion on the Commission's accounts based on an estimated material irregularity on legal aid expenditure.
 9. My 2010-11 report also noted an estimated error of £4.9 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 in relation to contributions that were not levied by the Commission when they should have been. My testing in 2011-12 identified a significant decrease in these error rates, to £1.4 million and £2 million, respectively. I do not consider these amounts to be material and consequently I have not qualified my opinion in this respect.

Progress since my last report

10. The Accounting Officer's Governance Statement¹ provides a comprehensive account of the internal control issues facing the Commission, the progress made against them and further work to be done.
11. The Commission has made significant improvements in the level of total irregular expenditure reported in 2011-12. The key areas of improvement are:
 - On Legal Help schemes for immigration and family, the estimated irregularity has fallen from £14.0 million to £2.8 million
 - On eligibility on the "Civil Representation scheme", the estimated irregularity has fallen from £18.2 million to £12.8 million.
12. These improvements are due to the Commission's increased focus on higher risk areas, enhanced assurance testing and significant recovery action. However, there are some areas where the level of error has not changed significantly, or has increased.

The Commission's compliance testing

¹ Legal Services Commission Annual Report and Accounts 2011-12, pg 40-49

13. In recent years, the Commission has established and integrated a compliance testing regime through which it seeks to obtain assurances and quantify the level of error arising on legal aid payments. Throughout the year, the Commission reviews payments and eligibility on a sample basis to confirm whether suppliers have met contractual requirements, and that claims are supported by sufficient evidence.

14. For 2011-12, I was able to satisfy myself that for the majority of the legal aid schemes this testing was identifying errors effectively and consistently. I was therefore able to rely on the majority of this work for my audit.

Payment irregularities

15. From my audit work, I have estimated £20.4 million of overpayments to legal aid providers as set out in the following table. This has reduced from £28.3 million in the prior year.

ESTIMATED PAYMENT IRREGULARITIES					
Legal Aid Scheme	2011-12				2010-11
	Population* £'m	Estimated overpayments £'m	Recoveries £'m	Estimated total irregularities £'m	Estimated total irregularities £'m
<u>CIVIL</u>					
Legal Help: Immigration and Family	97.0	10.8	(8.0)	2.8	14.0
Legal Help: Other	97.5	3.7	(0.5)	3.2	3.9
Civil Representation: Bills and Mediation Payments	780.2	2.7	(0.0)	2.7	3.3
Civil Representation: Very High Cost Cases (VHCC) payments	130.6	2.4	(0.0)	2.4	3.6
<u>CRIME</u>					
Crime Lower: Police Station and Magistrates' Court claims	380.9	5.9	(1.1)	4.8	2.3
Crime Higher: Crown Court payments to advocates and solicitors	610.7	4.9	(0.4)	4.5	1.0
Crime Higher: Very High Cost Cases (VHCC) payments	91.7	0.0	(0.0)	0.0	0.2
Total		30.4	(10.0)	20.4	28.3

* The populations shown are cash payments in the year

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

Legal Help

17. The Commission's testing of the Legal Help and Immigration schemes identified an estimated irregularity of £2.8 million. This represents a significant decrease from the estimated irregularity of £14.0 million in 2010-11, and is due to both reductions in overpayments as well as overpayment recoveries.
18. The estimated error on the Immigration Scheme has decreased from £8.9 million to £0.5 million. A substantial proportion of the 2010-11 and 2009-10 errors related to claims made by two significant providers who went into administration. The Commission has undertaken extensive closedown exercises for these providers this year.
19. The Immigration Scheme has also been subject to focused provider management activity by the Commission including regular contract management visits and compliance audits, which have enabled identification and correction of potential errors and further education of providers.
20. The estimated error on the Family Scheme has fallen from £5.1 million to £2.3 million. However, this scheme has the highest proportion of errors identified with some 11.1% (13.9% in 2010-11) of payments subsequently deemed to be irregular, before recoveries. As reported in prior years, the errors in relation to this 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.

Crime Lower

21. The Commission's testing of the Crime Lower scheme identified an estimated irregularity of £4.8 million, an increase of £2.5 million on the previous year. This increase is due to some providers billing incorrect amounts following the changes in fixed fees under the Legal Aid reforms, implemented in October 2010, and recent changes to the VAT rate.
22. The Commission has enhanced the online system through which providers submit claims, which has improved pre-payment validation of these claims. The Commission has also continued to work with providers to improve compliance, through feedback on common areas of error and issuing of contract notices on identification of significant non-compliance.

Crime Higher

23. Since April 2011, all claims made by solicitors and advocates in relation to Crown Court cases which started on or after 1 January 2011 have been assessed and paid by the Commission. Prior to this, all such claims were processed and assessed by HM Courts and Tribunals Service on the Commission's behalf.

24. The Commission's testing has identified that the estimated error has more than doubled since 2010-11. This is largely due to quality control issues as Commission staff become familiar with the rules on a scheme that has previously been contracted out. The Commission is addressing these issues through detailed feedback on common areas of error and additional training.
25. The Commission also identified that, in some cases, neither the provider nor the Commission held the records required to assess all elements of claims fully. There was a need to reconstitute records, which, in some instances, identified additional information not available at the time of the original assessment of the claim resulting in increased error rates. The Commission is working with providers to ensure that all supporting information is submitted with claims and plans to move to monthly testing to carry out more timely review.

Eligibility errors

26. I have identified an estimated £15.2 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 ELIGIBILITY IRREGULARITIES				
Legal Aid Scheme	2011-12			2010-11
	Population*	Error Rate	Estimated Total Error	Estimated Total Error
	£'m	%	£'m	£'m
Legal Help	179.0	1.1%	1.9	1.9
Crime Lower: Magistrates' Court	105.4	0.5%	0.5	1.1
Civil Representation	125.8	10.2%	12.8	18.2
Total of eligibility irregularities			15.2	21.2

* The populations shown are cash payments in the year

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

Civil Representation

28. For Civil Representation, the Commission must assess an individual's eligibility for legal aid before they can be represented at court.
29. As in 2010-11, 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.
30. The Commission has taken significant steps to enhance its controls in this area; improving the supporting evidence obtained enabling a more thorough assessment

of eligibility prior to the issuance of a legal aid certificate. These improvements have reduced the error rate substantially, to less than half that identified previously, and should lead to further significant reductions in irregularity in the future.

Developments in systems and controls since my last report

31. 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 address these, are explained in the Accounting Officer's Governance Statement.
32. The key developments since my previous report can be summarised as:
 - identifying and managing areas of risk;
 - improvements to internal processes and systems;
 - working with providers; and
 - recovering overpayments.

Identifying and managing areas of risk

33. The Commission has a better understanding of areas of risk and causes of regularity error. The compliance testing regime has been further enhanced and embedded into business as usual activity, with testing for a number of areas now conducted on a monthly basis so that common areas of error are identified and addressed on a more timely basis. During 2012-13, the Commission intends to move to monthly testing across the majority of the legal aid schemes. This will be particularly useful on schemes such as Crime Higher Crown Court payments to advocates and solicitors, where the error rate has increased this year.
34. The Commission has continued to develop its Provider Management Strategy. It has used data and results from previous visits to providers, on-going compliance testing and detailed data analysis of claim activity, to identify areas of high risk and reduce levels of error. The Commission has informed me that, as part of these on-going activities, it has issued over 830 contract notices to providers and terminated 29 contracts.

Improvements to internal processes and systems

35. The Commission has used the results of its compliance work and its on-going analysis of errors to inform the development of enhanced quality control.
36. The Commission has developed an organisation wide Financial Stewardship Plan to address fund risks, with each operational area having a supporting implementation

plan. This builds on the improvements already made against the first stage of this plan during 2010-11 and 2011-12.

37. There has also been a complete update of Standard Operating Procedures, supported by mandatory checklists to ensure quality and consistency across the business.

Working with providers

38. Results of compliance work have been fed back to providers. Where areas of common error have been identified, additional guidance is provided to ensure providers are aware of the issues and understand the steps required to ensure they are compliant. In addition, a number of compliance forums with providers have been established, to highlight errors and provide direction to sources of guidance.
39. During 2011-12 the Commission has also trialled the use of online training for providers and staff in areas of known high risk where scheme requirements have changed, for example Family Level 2 claims.

Recovering overpayments

40. The overall assurance programme undertaken by the Commission has led to the identification and substantial recovery of overpayments to suppliers. This work is ongoing, but recoveries of £10.1 million (2010-11: £7.1 million) have been made during the year.

Further steps planned and required by the Commission

41. The Commission continues to take steps to:
 - measure the overall level of error across the schemes;
 - examine the underlying (root) causes of error in those schemes where error remains high; and
 - based on this understanding, identify and implement appropriate measures to reduce these errors.
42. The Commission is further strengthening its compliance testing regime to ensure that it is obtaining all the assurances it requires. It is reviewing its assurance and compliance activities to implement a more co-ordinated and efficient approach. This includes greater focus on risk management of providers and improving the quality of the assurances provided.
43. The above is particularly important in light of the planned legal aid reforms under the Legal Aid, Sentencing and Punishment of Offenders Act, which received Royal Assent on 1 May 2012. Errors often result from changes to schemes when providers and staff may be unclear about the detailed scheme rules. Risk is further

heightened during the interim period as the Commission manages the existing schemes and implements new schemes. The Commission will need to reconsider its risks and assurance regime in light of these changes.

Progress relating to my qualified opinion on the 2010-11 receivables balance and related expenditure

44. My audit opinion includes a statement on whether the financial statements give a true and fair view of the Community Legal Service Fund and the Criminal Defence Service's affairs as at 31 March 2012 and of its net expenditure for the year then ended.
45. In 2010-11, I limited the scope of my opinion on the valuation of the net receivables balance and the movement in the impairment provision charged to the Statement of Comprehensive Net Expenditure. I found material error in the gross receivables balance and the Commission was unable to provide satisfactory evidence to support the model estimating the value of the net receivables balance (i.e. how much of the gross receivables balance was impaired).
46. The Commission has undertaken a substantial amount of work in 2011-12 to cleanse the recording and reporting of receivables. As a result of this work, the Commission had more complete and accurate records and was able to revise the impairment model. The Commission was also able to adjust the prior period balances as at 31 March 2011 and 2010. Therefore, I am able to provide an unqualified audit opinion for 2011-12 in respect of the receivables balance and related movements in expenditure.

How the Commission addressed the misstatement of receivables

47. The Commission's accounts disclose a receivables (debt) balance of £103.8 million in the Statement of Financial Position as at 31 March 2012. This balance represents amounts owing from legal aid recipients or providers totalling £265.1 million and a provision for impairment of £161.3 million to reflect the Commission's assessment of the recoverability of this balance. The impairment provision represents 61% of the gross receivables balance. This is a significant accounting estimate and is based on assumptions of the characteristics of receivables at an aggregated level.
48. However, the Commission continues to pursue its debts irrespective of the impairment until a business decision is made that the debt is irrecoverable, at which point it is written off.

Errors within the gross receivables balance

49. In my report on the Commission's 2010-11 accounts, I reported that my testing of a sample of debts had identified a significant level of error, which extrapolated to an overstatement of £50.4 million.
50. During 2011-12, the Commission commenced a review of its receivables balances in order to correct inaccuracies in the recorded amounts and to remove balances that the Commission will not be able to recover. These balances included those where the Commission is legally no longer able to pursue them, as well as instances where the Commission made a judgement that recoverability was uneconomical or highly unlikely due to a lack of supporting documentation for the debt. This cleanse exercise resulted in £48.1 million of receivables being written off. The Commission's analysis demonstrated that of this amount, £43.7 million relate to periods prior to 2011-12.
51. I performed testing on a sample of debts selected from the gross receivables balance as at 31 March 2012. Testing identified an estimated £8.4 million overstatement. This is not a significant level of error, and, therefore, I am satisfied that the gross receivables balance is not materially misstated.
52. The reduction in the gross receivables error compared to the prior year reflects a significant improvement in the accuracy of the value of receivables recorded by the Commission. The Commission will continue to review and cleanse the remaining debtor balances under the programme for migrating the data onto the new IT system. The Commission informed me that this will be accompanied by improvements in its controls. These controls will need to ensure that debts are accurately recorded and enable unpaid amounts to be pursued and collected efficiently.

The impairment model

53. The Commission estimates the amount by which the receivables balance should be impaired using an impairment model. In my report on the Commission's 2010-11 accounts, I reported that there was a lack of sufficient and reliable evidence to support the assumptions within the model.
54. During the year, the Commission implemented improved processes for estimating the impairment provision. It has updated the underlying assumptions in the impairment model to ensure they are more consistent with historical data and the current economic climate. The revised model and underlying assumptions also improved its predictive nature allowing the Commission to predict cash receipts in 2011-12 by applying the model to 2010-11 data.

Conclusions

55. The Commission continues to improve its processes, which has led to substantial reductions in the level of irregular payments made to legal aid providers, but there remains scope for further progress to reduce them further. At a time when the Commission is reducing its costs whilst implementing substantial reforms to legal aid this represents a significant challenge. The challenge is made harder because of the difficulties inherent in administering a means-tested system of entitlement, and from the complexity of the fee schemes paid under legal aid.
56. My audit of the Commission's financial statements for 2012-13 will again examine the level of irregular transactions. I will report on the progress that the Commission makes in addressing this issue. In addition, I will continue to monitor the Commission's on-going cleansing of receivables and improvements in the recording and collection of receivables.

Amyas C E Morse
Comptroller & Auditor General
10 July 2012

National Audit Office
157-197 Buckingham Palace Road
Victoria
London SW1W 9SP