

Item 9 - Annex 1 – Compensation Fund Financial statements

# SRA Compensation Fund

Annual Report and Financial Statements  
For the Year ended 31 October 2021

**Contents**

**Principal activities..... 1**

**Governance ..... 1**

**Operating and financial review ..... 3**

**Principal risks and uncertainties ..... 6**

**Statement of financial control ..... 7**

**Statement of the Council of the Law Society and SRA Board’s Responsibilities in  
respect of the financial statements..... 8**

**Independent auditor’s report to SRA ..... 10**

**Income and expenditure account for the year ended 31 October 2021 ..... 12**

**Balance sheet as at 31 October 2021 ..... 13**

**Notes to the financial statements for the year ended 31 October 2021 ..... 14**

## **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 or is likely to suffer:

- loss in consequence of the dishonesty of a defaulting practitioner or the employee or manager or owner of a defaulting practitioner; or
- 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 Limited (SRA) into the practice of a defaulting practitioner. From 1 June 2021 the activities of the SRA transferred to Solicitors Regulation Authority Limited, a company limited by guarantee.

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 SRA.

## **Governance**

In its role as the statutory approved regulator, the Council of the Law Society (the Council) has empowered the SRA to deal with all matters relating to the Fund. The financial management and administration of the Fund by the SRA is governed by the SRA Compensation Fund Rules 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.

Reference throughout this document to “the Society” refers to the Law Society as a royal charter body.

**Governance (continued)**

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

Anna Bradley	Chair
David Willis	Member to 31 December 2020
David Heath	Member to 31 December 2020
Paul Loft	Member
Barry Matthews	Member
Geoff Nicholas	Member
Tony Williams	Member
Peter Higson	Member
Selina Ullah	Member
Elizabeth Smart	Member from 1 January 2021
Dermot Nolan	Member from 1 January 2021
Vikas Shah	Member from 1 January 2021
Ann Harrison	Member from 1 January 2021

Chief Executive of the SRA:

Paul Philip

The Board delegated certain powers and duties during the financial year to the Audit and Risk Committee.

Members of the Audit and Risk Committee during the financial year under review were:

Paul Loft	Chair
Ann Harrison	Member from 1 March 2021
Vikas Shah	Member from 1 March 2021
Tony Williams	
David Willis	Member to 31 December 2020

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, predominantly as part of the annual practising fee collection exercise, by the SRA 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 £40 per individual and £760 per firm which holds client money (2020/21: £50 and £950 respectively) was approved by the Board at its meeting in July 2021 relating to the practising fee year 1 November 2021 to 31 October 2022. The total budgeted contribution for the 2021/22 practising year was £11.6m (2020/21: £14.5m).

Of the budgeted £11.6m in relation to the 2021/22 practising fee year, £5.2m had been invoiced at the end of October 2021 (2020: £6.3m) with a further £6.3m being invoiced by the end of December 2021. Contributions recognised during the year totalled £13.9m compared with £7.6m in 2020.

#### ***Investment income***

Investment income in the period has reduced as a result of reduced rates of return. Cash is invested in short term cash deposits. At the end of October 2021 the Fund had £49m in cash and investments compared with £58m at the end of October 2020.

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

During the year to 31 October 2021 grants were made to the value of £27.0m (2020: £10.3m).

In 2021 grant recoveries were £10m, an increase of £4.7m from 2020. 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 (STAs) held by the SRA.

The Fund received or reopened 1,260 claims in 2021 (2020: 1,120) and closed 1,360 (2020: 1,146). At the end of the year there were 537 open claims (2020: 637) with a total claim amount of £75.4m (2020: £84.6m).

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

Of the total grant recoveries, £1.1m (2020: £2.5m) 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.

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

In its role as the statutory approved regulator the Society is the Trustee of separate funds which vest in it as a result of interventions into solicitors' practices in accordance with statute. The Society has delegated the handling of these funds to the SRA who holds and administers them in accordance with the SRA Statutory Trust Rules. The SRA 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.

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 2021 the amount transferred was £0.4m (2020: £1.1m).

### ***Administrative costs***

Costs incurred during the year in administering, maintaining, applying and protecting the Fund were £7.3m (2020: £9.9m). Almost all Fund administrative costs are incurred by the SRA 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 SRA which totalled £4.1m (2020:£6.3m).

### ***Result for the year***

The deficit for the year was £10.0m deficit (2020: deficit £6.0m). The change year on year is due to the fact that cash balances were deliberately increased in 2018/19 to provide for future high value claims, as those claims are paid over a number of years the level of cash balances has reduced. A significant deficit was therefore expected in the years following the decision to increase the balance.

## Operating and financial review (continued)

### Balance sheet and cash flow

Accumulated funds at 31 October 2021 were £50.6m, compared with £60.6m at 31 October 2020.

Reserves are expected to reduce further during 2021/22. The cash balances in the Fund were increased in prior years to fund expected higher levels of claims. As these claims are paid the cash balance in the Fund reduces.

A significant amount of income for 2021/22 had not been invoiced at the end of October 2021. A significant amount of this was invoiced during November and December 2021. Contributions for the 2022/23 year are due to be collected from October 2022. The level of contributions will be confirmed by the SRA Board during 2022.

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 reduced by £10.0m overall (2020: £6.0m decrease).

The Compensation Fund's investments are in instant access managed cash funds and short-term cash deposit accounts.

### Open claims

Due to the predominantly cash accounting nature of the accounting policies of the Fund, explained further in note 1, no liability is recognised within these financial statements for open claims received.

The movement in open claims open during 2021 and 2020 are shown in the table below based on the original claims value recorded:

	<b>2021</b>	<b>2020</b>
	£m	£m
Claims open at 1 November	84.6	79.7
Claims closed or deleted during the year	(66.4)	(48.8)
Net change in value of open claims	(12.7)	0.1
Claims received or reopened during the year	69.9	53.6
Claims open at 31 October	75.4	84.6

We have estimated the grants that may result from the claims outstanding at the end of 2021 and consider that the balances in the Fund are sufficient to meet the potential liabilities as they fall due.

## 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 or are likely to suffer:

- loss in consequence of the dishonesty of a defaulting practitioner or the employee or manager or owner of a defaulting practitioner; or
- 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.

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 the Fund is a discretionary fund of last resort as outlined in the SRA Compensation Fund Rules. However, in practice the SRA 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 SRA 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.

### ***Ongoing Covid 19 Pandemic***

The Covid-19 outbreak has not had a significant impact on the Compensation Fund however the full extent of any impact on the profession may still take some time to be realised. Levels of contributions received in October 2021 – December 2021 are in line with expectations and the number of practising solicitors continues to increase year on year<sup>1</sup>.

The potential for a future impact was considered when setting the Compensation Fund contributions for 2021/22, and will be considered when setting the 2022/23 contributions. The Fund maintains significant reserves to provide for uncertainty and had £48.9m in cash at the end of October 2021. This had increased to £50.9m at the end of February 2022.

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<sup>1</sup> [SRA | Regulated population statistics | Solicitors Regulation Authority](#)

## 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 is approved by the Board and was most recently updated in November 2019. The Board reviews the effectiveness of the internal financial processes with financial management representatives and KPMG 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 Limited.

### **Solicitors Regulation Authority Limited**

Under delegated authority from the Council of the Law Society, the Solicitors Regulation Authority Limited (SRA) 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 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 has:

- 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 policies applied;
- prepared the non-statutory financial statements on the going concern basis unless it is inappropriate to presume that the Fund will continue in business;
- considered the going concern assessment in light of the ongoing Covid-19 pandemic including the potential impacts on the claims made against the Fund.

The SRA Board is 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. It is 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;
- appropriate governance arrangements are in place and are operated, such as by the activities of the SRA Audit and Risk Committee and the 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.

SRA Compensation Fund

**Independent auditor's report to SRA**

***Auditor's responsibilities for the audit of the financial statements***

BDO LLP  
Chartered Accountants  
Birmingham  
United Kingdom  
Date

BDO LLP is a limited liability partnership registered in England and Wales (with registered number OC305127).

Date: .....

## Income and expenditure account for the year ended 31 October 2021

### Income statement

	Note	2021 £'000	2020 £'000
<b>Income</b>			
Contributions received in the current year	7	13,877	7,583
		<b>13,877</b>	<b>7,583</b>
Grant recoveries	3	10,020	5,250
Investment income received	4	13	178
Residual balances received from Statutory Trust accounts	8	371	1,129
<b>Total Income</b>		<b>24,281</b>	<b>14,140</b>
<b>Expenditure</b>			
Grants paid	2	(27,021)	(10,269)
Administration costs	6	(7,278)	(9,842)
Auditors' remuneration – audit fees		0	0
Income tax	5	0	(63)
<b>Total Expenditure</b>		<b>(34,299)</b>	<b>(20,174)</b>
 (Deficit) / Surplus for the year		<b>(10,018)</b>	<b>(6,034)</b>
 <b>Fund balance as at 1 November</b>		<b>60,628</b>	<b>66,662</b>
<b>Fund balance as at 31 October</b>		<b>50,610</b>	<b>60,628</b>

All activities derive from continuing activities.

The notes on pages 14-19 form part of these non-statutory financial statements.

**Balance sheet as at 31 October 2021**

	Note	<b>2021</b> <b>£'000</b>	<b>2020</b> <b>£'000</b>
<b>Current Assets</b>			
Investments – cash funds		25,001	25,002
Bank and cash		23,885	32,952
Money owed from the SRA	8	1,724	2,674
<b>Total Current Assets</b>		<u>50,610</u>	<u>60,628</u>
<b>Current Liabilities</b>			
		-	-
<b>Total Current Liabilities</b>		<u>-</u>	<u>-</u>
<b>Net Current Assets</b>		<u>50,610</u>	<u>60,628</u>
<b>Accumulated Funds</b>		<u>50,610</u>	<u>60,628</u>

The notes on pages 14-19 form part of these non-statutory financial statements.

The financial statements of the Compensation Fund were approved by:

Paul Philip  
CHIEF EXECUTIVE, SRA

Anna Bradley  
CHAIR, SRA BOARD

Date:

## **Notes to the financial statements for the year ended 31 October 2021**

### **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 statement***

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 SRA 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 Statutory Trust Accounts (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 2021 (continued)**

### **1 Accounting policies (continued)**

#### ***Residual balances received from STAs***

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

#### ***Investment income***

Investment income is received monthly in the form of 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 SRA 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 SRA.

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 none were held under fixed term arrangements and are all available for withdrawal with no more than thirty two days notice with the majority available at no more than seven days notice.

## **Notes to the financial statements for the year ended 31 October 2020 (continued)**

### **1 Accounting policies (continued)**

#### ***Going concern***

In the current climate, the Board acknowledges the ongoing COVID-19 pandemic.

The Board has considered the level of reserves which, coupled with the fact that the Fund's grants are discretionary, means the Board believes the Fund has sufficient funds available to it to meet future obligations as they fall due.

The Fund holds significant cash reserves and contribution levels for 2021/22 have been set with the additional risks associated with Covid-19 in mind. The latest forecasts for the fund indicate that there will be continue to be significant reserves through the next 12 months and beyond, with the Fund forecasting £50.1m of cash reserves at March 2023.

As part of the year end audit process, the Board has also considered possible scenarios that would result in cash reserves being exhausted and considers that multiple worst case events would need to occur such as a 40% reduction in the profession, more than 100% increase in interventions with a 50% increase in cost and a 100% increase in the level of claim on each intervention. The likelihood of any of these scenarios individually is considered to be extremely low and the likelihood of all three almost inconceivable. There has been no significant impact on the Fund relating to the Covid-19 pandemic as at the end of February 2022.

The SRA also has the power to raise an additional levy on regulated individuals and bodies between the annual collections if required.

Based on the reforecasts and the available liquid resources, the Board believe that, while some Covid-19 uncertainty may exist, this does not pose a material uncertainty that would cast doubt on the Fund's ability to continue as a going concern for the foreseeable future, being a period of at least 12 months after the date on which the report and Financial Statements are signed. The Board, therefore, consider it appropriate for the accounts to be prepared on a going concern basis.

### **2 Grants paid**

Grants paid in 2021 totalled £27.0m (2020: £10.3m).

### **3 Grant recoveries**

Grants recoveries in 2021 totalled £10.0m (2020: £5.3m) of which £8.9m (2020: £2.7m) were recovered through rights of subrogation from the STAs with the remainder being recovered directly from solicitors.

### **4 Investment income received**

Interest received in 2021 totalled £13k (2020: £178k)

## Notes to the financial statements for the year ended 31 October 2021 (continued)

### 5 Income tax

Income tax is payable on gross interest earned during the year from money market funds and treasury deposits. Income tax falling due on investment income for the financial year totals £3k (2020: £36k).

### 6 Administration Costs

	<b>2021</b> <b>£'000</b>	<b>2020</b> <b>£'000</b>
Direct cost of processing Compensation Fund claims	1,843	1,868
Direct cost of intervention and other legal costs	<u>4,067</u>	<u>6,346</u>
<b>Total Direct Cost</b>	<u>5,910</u>	<u>8,214</u>
Allocated cost of other regulatory activity that administers and protects the Fund	1,093	1,302
Contribution to overhead costs	<u>275</u>	<u>326</u>
<b>Total Administration Costs</b>	<u><u>7,278</u></u>	<u><u>9,842</u></u>

All administration costs are incurred by the SRA and recharged to the Fund.

## **Notes to the financial statements for the year ended 31 October 2021 (continued)**

### **7 Compensation Fund contributions**

Contributions recognised in 2021 totalled £13.9m (2020: £7.6m) of which £5.2m (2020: £6.3m) related to the practicing year 2020/21. Of the expected £11.6m for the 2021/22 practicing year a further £6.4m had been invoiced by the end of January 2022 resulting in income in line with forecast for the year.

### **8 Related party transactions**

The Society has ultimate accountability for the maintenance of the Fund and the STAs, delegated to the SRA. Both the SRA and the STAs are therefore considered to be related parties for the purpose of financial reporting.

The SRA collects all Fund contributions on behalf of the Fund, as disclosed within the income and expenditure account. In addition, the SRA charges the Fund administration costs, as disclosed in note 6. Amounts due from the SRA at 31 October 2021 are £1.7m (2020: due from the SRA £2.7m) and are disclosed within the balance sheet.

Transactions with the STAs are recovery of grants under rights of subrogation and amounted to £8.9m (2020: £2.7m).

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 £0.4m in 2021 (2020: £1.1m).

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

There are no other significant related party transactions.

## **Notes to the financial statements for the year ended 31 October 2020 (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.

#### ***Open claims***

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.

No reliable 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 (STA), undistributed balances***

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

In 2021 this resulted in £0.4m being transferred from STAs to the Fund (2020: £1.1m). This is in addition to the funds received via rights of subrogation.

#### ***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, it is not possible to accurately quantify the amount due until the work has been completed. At the end of October 2021 the total balance held in STAs was £18.1m (2020: £23.0m).

#### ***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.