



The Law Society

## **The Law Society Compensation Fund**

**Report and financial statements**

**31 December 2006**

The Law Society  
Compensation Fund

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# The Law Society

## Compensation Fund

### **Trustees' report and statement of responsibilities**

#### **Constitution**

The Compensation Fund is maintained and administered pursuant to section 36 of the Solicitors Act 1974 and Schedule 2 of the Act as amended by the Courts and Legal Services Act 1990 and under the provisions of the Administration of Justice Act 1985.

The administration of the Fund is governed by the Solicitors' Compensation Fund Rules 1995 made under the section 36(8) of the Solicitors Act 1974 and section 9 of the Administration of Justice Act 1985.

The Compensation Fund is a statutory purpose trust and The Law Society of England and Wales (the "Law Society") acts as Trustee.

#### **The Law Society's role**

The Law Society has historically combined the responsibilities for regulating and representing solicitors in England and Wales. Although the Law Society remains a single legal entity, it separated the governance of its regulatory and representative functions in January 2006. The representative Law Society is responsible for the promotion of the interests of the profession, and for law reform issues; the Solicitors Regulation Authority has substantive responsibility for the regulation of solicitors; and the Legal Complaints Service has substantive responsibility for dealing with consumer complaints. Each of the three organisations has its own Chief Executive.

The Council of the Law Society is an elected body of solicitors. The solicitor and lay members of the Board of the Solicitors Regulation Authority, and of the Board of the Legal Complaints Service were appointed in accordance with best practice for public appointments ('Nolan principles'). No-one may be a member of the Council and of the regulatory Boards at the same time.

The term 'the Law Society' therefore applies in a legal sense to the totality of the three organisations, and in a functional sense to the representative organisation.

#### **The Combined Code**

The Society is a body incorporated by Royal Charter. Although this means that the Combined Code on Corporate Governance does not apply to the Society, the Society is committed to the principles of corporate governance.

Some of the Combined Code's provisions are not directly applicable, because the Society is not a listed company. The following paragraphs explain the Society's approach in relation to the Combined Code's main sections, and the areas of non-compliance.

#### **Strategic management**

The Society's governing body is the Council. The Council maintains strategic oversight but delegates most corporate functions to the Corporate Governance Board ('the Board'). In practical terms, for the purposes of the Combined Code, the Board is the nearest equivalent of a plc Board of Directors.

The Council's responsibilities are derived from statute, the Society's Charter, Bye-Laws and General Regulations. The Charter and Bye-Laws reserve some matters to the annual general meeting of Law Society members.

# The Law Society

## Compensation Fund

### **Trustees' report and statement of responsibilities (continued)**

There are 100 places on the Council. Members are elected for a four year term, which is renewable. There is no direct equivalent of non-executive directors. The Remuneration Committee has two non-Council members; the Audit Committee has six non-Council members, of whom four are not solicitors. The Chair of the Audit Committee and the Chair of the Remuneration Committee are non-Council members.

The Boards of the Legal Complaints Service and Solicitors Regulation Authority are not represented on the Corporate Governance Board, or on the other committees of the Council.

Induction is provided for Council members. Members of the Board and the Audit Committee regularly review risk management issues.

### **Regulation and complaints handling**

The Society has separated the governance of its regulatory and representative functions by establishing a Regulation Board and a Consumer Complaints Board which, since January 2006, have had substantive responsibility for regulation and consumer complaints, in so far as this can be lawfully delegated by the Council. The Board members were appointed in accordance with best practice for public appointments ('Nolan principles'). The Consumer Complaints Board has a majority of lay members, while the Regulation Board has a solicitor majority, with significant lay membership. No-one may be a member of the Council and of the Regulatory Boards at the same time.

From January 2007, these Boards were renamed the Board of the Solicitors Regulation Authority (SRA) and the Board of the Legal Complaints Service (LCS). The SRA is the identity given to the Society's regulatory functions; the LCS was formerly the Consumer Complaints Service.

In the future, and as explained in the Office-holders' report below, following the Legal Services Bill which is expected to receive Royal Assent in June 2007, complaints handling will become the responsibility of a separate body, the Office for Legal Complaints (OLC). The Society's intention is that its current operation will be the subject of a TUPE transfer to the OLC. Post-legislation the Society will be the approved regulator responsible to a new Legal Services Board for the performance of its regulatory functions by the SRA.

### **Objectives and activities of the fund**

Under the provisions of the Solicitors Act 1974, Schedule 2, a Solicitor is required to pay an annual contribution of such an amount as is determined by the Law Society Council (in addition to the Practising Certificate fee).

The purpose of the Fund is to make discretionary grants to those persons who have suffered loss or hardship as a consequence of the dishonesty of a solicitor or his or her employee, or by a solicitor's failure to properly account for money.

### **Office holders**

The Society has three office-holders: the President, Vice-President and Deputy Vice-President. They hold office for one year at a time. Each year, the Council elects the Deputy Vice-President (DVP); the previous year's DVP becomes Vice-President and the Vice-President becomes President. The hand-over takes place at the AGM in July.

The Office-holders are the Society's main ambassadors, and represent the Society at home and abroad. The President is a full-time appointment. The President chairs the Council.

# The Law Society

## Compensation Fund

### **Trustees' report and statement of responsibilities (continued)**

The Vice-President and the Treasurer co-chair the Board ('Treasurer' was a title customarily given to the Chair of the former Finance & Resources Board, and has been retained for the Board member who has primary responsibility for financial matters).

### **Chairs of the regulatory boards**

The two regulatory boards each have a chair. The Chair of the Board of the Solicitors Regulation Authority is Peter Williamson. The Chair of the Board of the Legal Complaints Service is Shamit Saggar.

### **Chief executives**

In 2006, Janet Paraskeva left the Society. Three new Chief Executives were appointed: Antony Townsend to lead the SRA, Deborah Evans to lead the LCS and Desmond Hudson to lead the Law Society.

The Chief Executives are responsible for implementing policy, for the management of staff and for ensuring that the Society, the SRA and the LCS operate effectively and efficiently. Each Chief Executive is responsible for a budget approved by the Council.

### **The Board**

The Council formed the Corporate Governance Board on 1 January 2006. Most of the members of the former Main Board and the Finance & Resources Board as at 31 December 2005 are now members of the Board.

The Board is responsible for the preparation of financial statements which give a true and fair view of the fund's position at the end of the financial year and of any surplus or deficit. In preparing the financial statements for 2006, the Board has:

- selected suitable accounting policies and then applied them consistently;
- made judgements and estimates that are reasonable and prudent;
- stated whether applicable accounting standards have been followed; and
- prepared the financial statements on the going concern basis.

During 2006 the Board was responsible for ensuring that proper accounting records were kept. The Board was also responsible for the system of internal control, for safeguarding the assets of the Fund and for taking reasonable steps for the prevention and detection of fraud.

### **Accountability and audit**

The relevant Combined Code provisions are met, except that there are no interim or price-sensitive reports to include in the assessment of the Society's financial position. There is an organisational structure with defined roles for the Corporate Governance Board and the Audit Committee.

### **Auditors**

A resolution to appoint BDO Stoy Hayward LLP as the Society's auditors for the 2006 accounts was approved at the July 2006 Annual General Meeting.

# The Law Society

## Compensation Fund

### Trustees' report and statement of responsibilities (continued)

#### Audit Committee

The members of the Audit Committee are listed on page 5. The Committee met seven times in 2006. Its terms of reference are consistent with the Combined Code, as far as is possible given the Society's management structure and governance. They include responsibility for the review of internal control and the overseeing of action required as a result of matters raised by the external auditors. The Committee also reviews the plans and monitors the progress of the Internal Audit Unit. The Council will consider the Committee's terms of reference when the governance structures for the future Law Society have been settled.

For 2006 an annual review of internal control has been undertaken. The Internal Control Statement resulting from this review appears below.

#### Internal control

The Society recognises the value of the internal control principles in the Combined Code and adheres voluntarily to it.

#### Board membership 2006

The Combined Code requires presentation of the attendance record of the board of directors. Attendance of Council members at Council meetings is recorded in the minutes, and is available to members of the Society on request. Given the Council's size the records are not shown here.

The membership of the Corporate Governance Board and the Audit Committee are as follows.

The CGB membership from 1 January 2006 to 31 December 2006 was:

Kevin Martin	(President until 14 July 2006)
Fiona Woolf	(President from 14 July 2006, having been Vice-President)
Andrew Holroyd	(Vice-President from 14 July 2006, having been Deputy Vice-President)
Paul Marsh	(Deputy Vice-President from 14 July 2006)
Robin ap Cynan	(Resigned 26 May 2006)
Andrew Caplen	
Helen Davies	
Nigel Day	(Appointed 10 July 2006)
Philip Hamer	(Treasurer)
Bob Heslett	
Alexandra Marks	
Sue Nelson	
John Pickup	(Resigned 8 February 2006)

# The Law Society

## Compensation Fund

### Trustees' report and statement of responsibilities (continued)

Rodney Warren

Janet Paraskeva (Chief Executive until 31 August 2006)

Desmond Hudson (Chief Executive from 1 September 2006)

Evelynne Gilvarry (non-voting) (Director of Representation and Law Reform)

Frances Low (non-voting) (Director of Legal Services)

Bruce Minty (non-voting) (Director of Finance & Resources, resigned 23 February 2007)

Bill Bilimoria (Interim Group Finance Director from 26 February 2007)

Russell Wallman (non-voting) (Director of Strategic Policy)

The membership of the Audit Committee from 1 January 2006 to 31 December 2006 was:

Stephen Brooker (Chair)

Richard Bagley (Retired 31 August 2006)

Sue Carter<sup>#</sup>

Stuart Collins

Michael Lawson

Geoffrey Mitchell


Kevin Mortell (Resigned 28 September 2006)


Murray Ross (From 5 October 2006)

Michael Singleton<sup>#</sup>

<sup>#</sup>Council Members of the Audit Committee. The remainder are independent members.

Approved by the Corporate Governance Board of the Law Society on behalf of the Council of the Law Society and signed on behalf of the Law Society, the trustee.

F Woolf  President

P Hamer  Treasurer

15 JUNE 2007

# The Law Society

## Compensation Fund

The Law Society has delegated the operational responsibilities of managing the Compensation Fund ("the fund") to the Solicitors Regulation Authority (SRA) and therefore the Chief Executive of the SRA has assumed full responsibility of the fund managements. His report follows:

### **Report of the chief executive of the Solicitors Regulation Authority**

The Compensation Fund is constituted and maintained by the Law Society pursuant to the Solicitors Act 1974, section 36 and Schedule 2. It is a discretionary fund of last resort.

The object of the Fund is to relieve the loss of those who have lost money as a result of a solicitor's dishonesty or failure to account.

Every year, qualifying solicitors are required to pay a contribution to the Compensation Fund. For the 2005/06 practice year the full contribution rate was £ 500. This contribution is calculated so the fund is maintained at a viable level sufficient to meet grants made during the year. The 2006/07 full contribution rate, collected in November 2006, was to be reduced to £400. At the beginning of June it was discovered that contributions to the Compensation Fund collected for the year 2006/7 were incorrect. Due to an administrative error, some solicitors had not received the benefit of the reduction in contribution set for that year by Council when it met in July 2006. The individual sums over-collected were either £100 or £50. We have identified that about 36,000 individuals have been affected by this and the amount over collected is £3.5m. As soon as the error was identified, I issued a public apology, and in consultation with the Society's Audit Committee and the Law Society initiated an action plan with the objective of promptly refunding the overpayment plus interest during July 2007. The SRA will work with the Audit Committee and in consultation with the Law Society to review the causes of the error, to improve the control of the Compensation Fund, and to put in place measures to minimise the risk of a recurrence. Work already started by the SRA to improve the management of the Fund will feed into this review. Further details are shown in note 8.

In 2006, there were individually no huge defaults that threatened the Fund and grant payments were a little less than experienced in previous years. In many cases grants related to interventions resolved in previous years. Compensation Fund grants are almost invariably made in relation to firms that have been subject to intervention. It has been customary to distinguish between which one or more of the grounds was suspected dishonesty and other grounds mainly because the former are, by statute, funded from Compensation Fund. There has been a trend from 2004 of fewer dishonesty interventions and this has been sustained as more non-dishonest interventions were authorised.

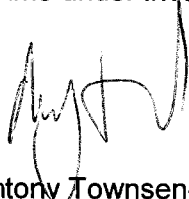
During the year the Fund was paid substantial sums from monies held on statutory trusts following intervention pursuant to rights of subrogation. Receipts pursuant to rights of subrogation of almost £ 9.9 million have been recorded. The Fund also recovered substantial costs from defaulting solicitors that offsets the costs of the Fund. Work continues in this area with the promise of more payments from the statutory trusts in 2007.

At the year end, and as a result of prudent financial management, the financial health of the Compensation Fund remains sound for the forthcoming year.

# The Law Society

## Compensation Fund

Compensation Fund claims processing during 2006 was generated by intervention activity. The year-end position was 14 interventions on the grounds of suspected dishonesty (2005: 11) and 36 other interventions (2005: 49) made during the year. The Fund administration processed and closed 3,752 claims in the year and retained a work-in-progress of 3,362 claims under investigation valued at £ 21.6 million.



Antony Townsend

Chief Executive

Solicitors Regulation Authority

# **Report of the independent auditors to the trustee of the Compensation Fund**

We have audited the financial statements of the Compensation Fund for the year ended 31 December 2006 which comprise the statement of receipts and payments, statement of assets and liabilities and related notes. The financial statements have been prepared under the accounting policies set out therein.

## **Respective responsibilities of the trustee and auditors**

As described in the statement of trustee's responsibilities, the trustee is responsible for the preparation of the annual report and financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view in accordance with the relevant reporting framework and whether the information given in the trustee's report is consistent with those financial statements. We also report to you if, in our opinion, the Compensation Fund has not kept proper accounting records or if we have not received all the information and explanations we require for our audit.

We read the trustee's report and report of the officers and consider the implications for our report if we become aware of any apparent misstatements within them.

Our report has been prepared pursuant to the requirements of the constitution of the Compensation Fund and for no other purpose. Our audit work has been undertaken so that we might state to the Compensation Fund's trustee those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Compensation Fund and the Compensation Fund's trustee, for this report and we hereby expressly disclaim any and all such liability.

## **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Trustee in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Compensation Fund's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

## Opinion

In our opinion

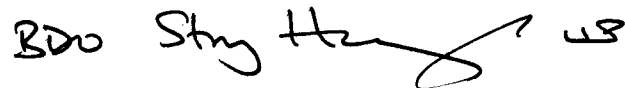
- the financial statements have been properly prepared in accordance with the accounting policies set out therein; and
- the information given in the Trustee's Report is consistent with the financial statements.

## Emphasis of matter

In forming our opinion, we have considered the adequacy of the disclosures made in notes 3 and 4 concerning the uncertainty surrounding the outcome of the potential amounts owed to the Statutory Trust Accounts (STAs) and owed from the STAs.

The rightful beneficiary of these monies is not always known. The Compensation Fund may have a legal entitlement to some of these monies, and may have a liability to refund some sums to be held on statutory trust, and we understand that this may be clarified by the courts in due course. It is not possible to quantify the effects, if any, of the resolution of this significant uncertainty.

In view of the significance of this uncertainty, we feel it should be brought to your attention, but our opinion is not qualified in this respect.

A handwritten signature in black ink, appearing to read "BDO Stoy Hayward LLP" with a stylized flourish at the end.

**BDO STOY HAYWARD LLP**

Chartered Accountants

London

19 June 2007

The Law Society  
Compensation Fund

**Statement of receipts and payments: Year ended 31  
December 2006**

	Note	2006 £'000	2005 £'000
<b>Receipts</b>			
Contributions received:			
- from domestic solicitors for current year	2(a)	23,156	22,521
- from foreign lawyers		203	211
- in respect of previous years		302	568
Amounts recovered from defaulting solicitors	2(b)	641	375
Bank deposit and loan interest		1,560	1,588
		<u>25,862</u>	<u>25,263</u>
<b>Payments</b>			
Grants paid		(9,466)	(13,282)
Less:			
Grants recovered via rights of subrogation		9,888	4,824
	2(c)	422	(8,458)
Administration, legal and other professional charges	3	(14,532)	(16,082)
Reinstatement of Statutory Trust Accounts	4	-	(6)
Auditors remuneration		(20)	(20)
Value Added Tax irrecoverable		(380)	(727)
Income tax		(268)	(94)
		<u>(14,778)</u>	<u>(25,387)</u>
Operating surplus/(deficit) for the year		<u>11,084</u>	<u>(124)</u>
Fund at 1 January		<u>40,963</u>	<u>41,087</u>
Fund at 31 December		<u><u>52,047</u></u>	<u><u>40,963</u></u>

All activities derive from continuing operations.

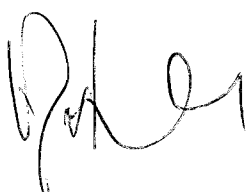
The Law Society  
 Compensation Fund

**Statement of assets and liabilities: As at 31 December 2006**

	Note	2006 £'000	2005 £'000
<b>Current assets</b>			
Monies invested in a managed fund	6 & 8	51,248	40,496
Other debtors		250	125
Amounts owed by the Law Society		669	-
Bank & cash		31	682
		<hr/> 52,198	<hr/> 41,303
<b>Current liabilities</b>			
Law Society		(152)	(340)
		<hr/> 52,047	<hr/> 40,963
<b>Net current assets</b>		<b>52,047</b>	<b>40,963</b>
<b>Total assets less current liabilities</b>		<hr/> <b>52,047</b> <hr/>	<hr/> <b>40,963</b> <hr/>
<b>Accumulated Fund</b>		<b>52,047</b>	<b>40,963</b>

The financial statements of the Compensation Fund were approved on 15 June 2007.  
 For and on behalf of the Law Society, the trustee of the Fund.

F Woolf  PRESIDENT

P Hamer  TREASURER

# The Law Society

## Compensation Fund

### Notes to the accounts: Year ended 31 December 2006

#### 1. The Compensation Fund

The Compensation Fund is maintained and administered pursuant to section 36 of the Solicitors Act 1974 and Schedule 2 of the Act as amended by the Courts and Legal Services Act 1990 and under the provisions of the Administration of Justice Act 1980.

The object of the Fund is to enable the Society to make discretionary grants to those persons who have suffered loss by reason of the dishonesty of a solicitor, or his or her employee, or to an applicant who has suffered hardship as a consequence of a failure by a solicitor to account for money.

The administration of the Compensation Fund is governed by the Solicitors' Compensation Fund Rules 1995 made under the section 36(8) of the Solicitors Act 1974 and section 9 of the Administration of Justice Act 1985.

#### 2. Accounting policies

The financial statements are prepared on a Receipts and Payments basis, which is not in accordance with UK generally accepted accounting practice, and accordingly do not reflect a true and fair view of the state of affairs of the Fund, which would have required the accounts to have been prepared on an accruals basis.

Additionally, the financial statements do not comply with UK generally accepted accounting practice because they do not present a cash flow statement (a requirement of FRS1 revised), they omit disclosure of related party transaction (a requirement of FRS 8) and they do not provide the required tax disclosure as per FRS19.

##### (a) Contributions

Annual contributions received from domestic and foreign lawyers are credited to the Fund on a cash received basis. Since they represent part of the overall fund balance, and may be used to provide cover for future claims in any year against the Fund, they are not apportioned to the contribution year on an accruals basis.

Prior year contributions occur from delays due to various regulatory investigations.

##### (b) Amounts recovered from defaulting solicitors

These amounts represent the costs of intervention and administration of the intervened practice recovered from the related business, individuals or from other parties such as the advisers to the defaulting solicitor's practice. These recoveries, which are stated gross in the financial statements, offset the overall costs incurred by the Fund which are reflected in expenses.

##### (c) Grants

Grants paid by the Compensation Fund are discretionary in nature and are accounted for when paid. Grant authorisation is given by the Adjudication Panel or an authorised Adjudicator under delegated authority from the Solicitors Regulation Authority board.

Where grants are made and subsequent investigation identifies a related client account, usually held by the Society as Statutory Trustee, funds may be subrogated from the related client money account in order to re-instate the Fund, provided that certain procedures are followed. Such subrogated funds receipts are reflected under grants recovered.

# The Law Society

## Compensation Fund

### Notes to the accounts: Year ended 31 December 2006 (continued)

#### (d) Claims under investigation

The capital value of claims notified and under investigation, less amounts already paid on those claims, is recorded in the notes to these accounts. No deduction is made to reflect the amount by which the amounts claimed may exceed the amounts ultimately paid by way of grant.

### 3. Administration, legal and professional charges

These charges represent the operating cost of administering, maintaining, applying and protecting the Fund. This includes staff costs and expenses incurred by the Law Society and recharged to the Fund according to agreed cost allocation rates, the legal fees incurred when intervening in a practice and in the continued administration of the business, and professional fees incurred by the Fund management team.

	<b>2006</b>	<b>2005</b>
	<b>£'000</b>	<b>£'000</b>
Direct cost of processing Compensation Fund claims:		
• Staff costs	1,244	1,183
• Other expenses	407	789
• Direct cost of Intervention and other legal costs	2,565	3,583
<b>Total Direct Costs</b>	<b>4,216</b>	<b>5,556</b>
Allocated cost of other regulatory activity the administers and protects the Fund:		
• Staff costs	4,235	4,115
• Other expenses	1,126	1,349
<b>Total Allocated costs</b>	<b>5,361</b>	<b>5,454</b>
Contribution to premises costs and other central overheads.		
Premises	377	573
Shared services contribution †	4,578	4,489
<b>Total Overheads contribution</b>	<b>4,955</b>	<b>5,052</b>
<b>Total Administration, legal and professional charges</b>	<b>14,532</b>	<b>16,082</b>

† The shared service contribution represents a charge levied to cover the cost of the Law Society central services including Human Resources, Finance, ICT, Strategic Policy, and Legal and Corporate services.

# The Law Society

## Compensation Fund

### Notes to the accounts: Year ended 31 December 2006 (continued)

#### 4. Contingent asset – Statutory Trust Accounts

The Law Society is trustee of funds vested in it as a result of intervention into a firm of solicitors and is responsible for ensuring that the funds are properly accounted for and distributed appropriately. These cash balances are referred to as the Statutory Trust Accounts (STAs). The Fund is able properly to recover from those cash balances grants it has made provided certain procedures are followed.

The work performed by the Law Society to reconcile STAs and the Fund and assess the overall position is well progressed. An application to the Chancery Division of the High Court for guidance on how to deal with STAs was filed in January 2005. Judgment was handed down on 14 March 2006. Investigative work to trace beneficiaries continues and has been reasonably successful particularly with intact accounts, and payments have been made. A targeted advertising campaign is ongoing to identify other potential beneficiaries, so far with limited results.

The High Court on 14 March 2006 determined that the Statutory Trusts held by the Law Society are subject to public law rather than the private law of trusts. It also determined that the Law Society has power to determine who is beneficially entitled to the funds taken in trust as a consequence of intervention pursuant to public law principles in a bona fide, rational and reasonable way, and taking note of private law trust principles. The Society will determine from its investigations a "best list" of beneficial owners.

This means that in cases where the Compensation Fund has made payments the recovery of grants pursuant rights of subrogation may now be exercised. This will be done over time on a case by case basis and it is difficult to estimate the likely total but it will probably exceed £15 million. Interim distributions are possible where the amount due to the Compensation Fund is established and sufficient can be retained to meet the maximum of any claims from other beneficiaries. After a long period of inability to make distributions on the basis of legal advice, interim and final distributions are now underway.

The judgment also allows the Law Society to recover costs incurred in determining beneficial entitlement and making distribution. The Society has indicated that it will only do this from un-distributable balances.

During the latter part of the year the first payments from the STAs was received by the Fund. 19 payments totalling £ 9,888,221 were transferred from the Statutory Trusts relating to the following client accounts/interventions. The largest payments were:

<u>Intervention/Client Account (Year of Intervention)</u>	<u>Amount</u>
Carrick Carr & Wright (2002)	£ 3,190,497
Carter Woods & Co (2003)	£ 611,447
M A Watts (2005)	£ 582,483
Robinsons (2004)	£ 813,385
Pawson & Murray (2004)	£ 878,698
14 Other payments less than £ 500,000	£ 3,811,711

# The Law Society

## Compensation Fund

### Notes to the accounts: Year ended 31 December 2006 (continued)

At 31 December 2006, £ 55,895,225 (2005: £ 55,718,059) was held by the Law Society as statutory trustee and comprised designated deposit accounts, office deposit accounts and the current account. The rightful beneficiary of these monies is often not known, and in some cases may never be known. The Compensation Fund may have a legal entitlement to some of these monies.

This contingent asset, being the unknown amount that may be remitted from the STAs to the Fund has been excluded from the Fund's statement of assets and liabilities.

#### 5. Amounts owed to the Statutory Trusts

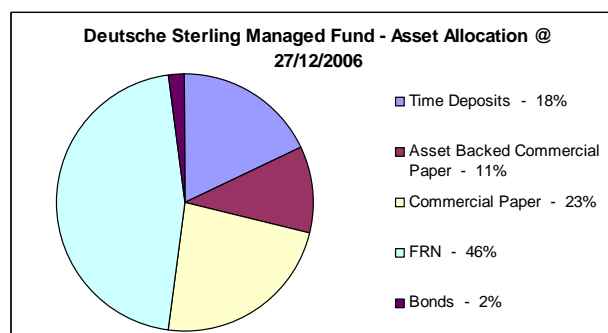
The latest estimate of amounts possibly owed to the Statutory Trusts, as at 31 December 2006 is £ 5,791,541 (2005: £ 5,594,433). This includes estimated interest of £ 1,139,488 (2004: £ 942,380).

This represents client monies recovered by the Fund either directly or indirectly from defaulting solicitors before 31 December 2001, in a manner which may have been inconsistent with the Society's fiduciary duties. These monies are held within the Fund's current assets balance. However, they are possibly repayable to the Society as trustee of the Statutory Trusts. Work is underway to establish what would have been the Fund's proper subrogated claim in relation to these transfers. This will, where evidence is available, establish whether the amounts paid to the Fund were, after all, justifiable or, more likely, partially justifiable. An application to court may be needed to establish what can be done with monies where it is impossible to establish the position.

#### 6. Money invested in a managed fund

The treasury strategy for the Compensation Fund is a conservative investment that focuses on the Deutsche Managed Sterling Fund supported by deposit and current accounts held with Barclays Bank Plc.

The Sterling Fund provides a high level of current income while preserving capital by investing in a diversified portfolio of Sterling denominated short term debt and debt related instruments. The fund size is £ 307 million of which the Compensation Fund investment as at 31 December 2006 represented 16.7% of that fund. The Deutsche Sterling Managed fund is an "AAA" rated fund (Moody's and S&P ratings).



As at 31 December 2006 the amount held on investment was £ 51,247,571 (2005: £40,495,425) earning gross interest of £ 1,542,145 (2005: £ 1,566,156) before tax, providing an average annual yield of 4.29%, 19 basis points above the average interest rate applicable to the bank deposit account.

# The Law Society

## Compensation Fund

### Notes to the accounts: Year ended 31 December 2006 (continued)

#### 7. Claims under investigation

At 31 December 2006, claims under investigation net of grants already authorised in regard to these claims totalled £ 21,560,345 (31 December 2005: £ 21,042,172).

Not all of these claims are expected to qualify for a grant in equal amount from the Fund. The capital value of £ 21,560,345 (2005: £21,042,172) does not take into account sums that may be received by the Fund by way of recovery or of any additional discretionary grants that may be made as compensation for loss of interest on earnings.

The Fund cover on 31 December 2006 was 242% (31 December 2005: 202%) representing 242 pence for every pound claimed.

The average cover for the year 2006 based on the average claims under investigation was 162% (2005: 154%) representing an average 162 pence for every pound claimed.

#### 8. Post balance sheet event (compensation fund overpayments)

Since the year end, it has been discovered that the Compensation Fund had collected some categories of annual contributions from firms during the year ended 31 December 2006 at a higher rate than that determined by the Council of the Law Society. The amount overcollected is £3.5m, which will be refunded to the payers, with interest. As the accounts of the Compensation Fund are prepared on a cash basis, this refund is not recognised as a liability in the 31 December 2006 balance sheet.

The administration costs of repayment will not be charged to the Compensation Fund. SRA has agreed to pay for this activity.