The Law Society

Consolidated Report and Financial Statements

The Law Society

31 December 2005

Report and financial statements

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Council's report and statement of the Council's responsibilities

The Law Society's role

The Law Society is the regulatory and representative body for solicitors in England and Wales. The Society is committed to promoting solicitors as an independent and effectively regulated profession. It aims to ensure that the public has complete confidence in the services that solicitors provide to them. The Society strives to guarantee:

- To the public – access to high-quality legal services;
- To solicitors – vigorous promotion of their interests; and
- To society – a leading voice on law reform.

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 delegated most corporate functions to the Main Board and Finance & Resources Board. In practical terms, for the purposes of the Combined Code, the Main Board was 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.

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, although, until 31 December 2005, the Council had five lay members. 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 is a non-Council member; as, from 2006, will be the Chair of the Remuneration Committee.

Induction is provided for Council members. Members of the Main Board and the Audit Committee received training in risk management in 2005.

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.

Council's report and statement of the Council's responsibilities (continued)

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. In 2005, the Vice-President chaired the Main Board.

The Chief Executive is responsible for implementing policy, for the management of the Society's staff and for ensuring that the Society operates effectively and efficiently, within the budget approved by the Council.

Auditors

Deloitte & Touche LLP were the Society's auditors for the 2005 accounts.

A resolution to appoint BDO Stoy Hayward LLP as the Society's auditors for the 2006 accounts will be proposed at the forthcoming Annual General Meeting.

The Board

The Council's Corporate Governance Board [1] is now responsible for the preparation of financial statements which give a true and fair view of the group's position at the end of the financial year and of any surplus or deficit. In preparing the financial statements for 2005, the Corporate Governance 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 2005 the Main Board was responsible for ensuring that proper accounting records were kept. The Main Board was also responsible for the system of internal control, for safeguarding the assets of the Society and for taking reasonable steps for the prevention and detection of fraud.

The directors of the companies whose accounts are consolidated with those of the Society are similarly required to prepare accurate financial statements, keep proper accounting records and safeguard the companies' assets.

The consolidated financial statements include the Society and its subsidiaries (together the 'group').

Governance changes in 2006

Corporate Governance Board

A Corporate Governance Board was formed on 1 January 2006. Most of the members of the Main Board and the Finance & Resources Board as at 31 December 2005 are now members of that Board. This report relates primarily to 2005, and therefore to the activities of the Main Board and the Finance & Resources Board.

[1] The Corporate Governance Board replaced the Main Board and the Finance & Resources Board on 1 January 2006.

Council's report and statement of the Council's responsibilities (continued)

Separation of Regulation and Representation

The Society has separated the governance of its regulatory and representative functions by establishing a Regulation Board and a Consumer Complaints Board which, from January 2006, have substantive responsibility for regulation and consumer complaints, in so far as this can be lawfully delegated by the Council. The Boards operated in shadow form from 1 September – 31 December 2005.

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.

In 2006, chief executives to lead the Regulation and Consumer Complaints functions will be appointed.

Also in 2006 the Council is conducting a major consultation of the profession on future of the Society's representative and membership service functions. New governance arrangements will certainly flow from changes to those functions.

Remuneration

In 2005 payments were made to:

- the Office Holders or their firms or employers;
- the five lay members of Council (until 31 December 2005); and
- the members of the regulatory Boards.

Council members received expenses only.

From 2006, the Chair of the Remuneration Committee will also receive payment.

The Remuneration Committee advises on compensation to the Office holders, and Council, Board and committee chairs and members; it approves the remuneration arrangements for the Chief Executive and senior management team.

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 (the Main Board and the Finance & Resources Board in 2005) and the Audit Committee.

Audit Committee

The members of the Audit Committee are listed on page 11. The Committee met seven times in 2005. Its terms of reference are consistent with the original version of 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.

Council's report and statement of the Council's responsibilities (continued)

For 2005 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 principle in the Combined Code, and adheres voluntarily to it. In doing so, the Society acknowledges that internal control systems are designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss. The preceding paragraphs explain how the Society's structures relate to the main provisions of the Combined Code.

The Council gave specific responsibility for internal control to the Main Board, although all Boards have risk-management responsibilities. The Main Board was therefore primarily responsible for reviewing the effectiveness of the Society's system of internal control in 2005.

Throughout the year, the Main Board received regular progress reports on the achievement of Strategic Objectives and any related financial implications and control issues. The Main Board received updates on the strategic risk register and associated action plans, which were completely revised in the final quarter.

The Council approves revenue and capital budgets annually. The Council, the Main Board and Finance & Resources Board have approved the budgets for 2006 and these are subject to continuing review by the Chief Executive in terms of actual performance against plan.

The Audit Committee also regularly monitored risk and control issues. The Scrutiny Committee reviewed the exercise of delegated powers by the Main Board and its Subsidiary Boards. The Remuneration Committee approved the remuneration arrangements for the Chief Executive and Senior Management Team, and advised on compensation to the Office-holders, Chairs and members of committees, Council members and members of the regulatory Boards.

The Internal Audit Unit carried out its annual assurance review for 2005, and, in addition, the Corporate Governance Board instituted its own review of the control system, based upon the self-assessment guidance in the Combined Code (the 'Turnbull' section).

On the basis of this, the Corporate Governance Board is satisfied that its predecessor, the Main Board, received sufficient information to review the effectiveness of the Society's system of internal controls.

Although the Society is not bound by the Combined Code, it chooses to follow its provisions wherever that is practical. There are structural differences between the Society and a company which mean that the Society cannot comply with certain provisions. Accordingly, the Society discloses that, of the Combined Code provisions that are directly relevant, the following are those with which it does not comply:

Council's report and statement of the Council's responsibilities (continued)

Clause		Comment
A.1 A.1.3	The Board The chairman should hold meetings with the non-executive directors without the executives present. Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman's performance (as described in A.6.1) and on such other occasions as are deemed appropriate.	The Society has no comparable mechanism to non-executive directors. The Code envisages non-executive directors as having a key role in the corporate sector, in checking any excesses of executive directors. The Society has an entirely different model of governance, based upon a framework of regulations and strategic overview by the Council. It is these which are designed to provide a check on the executive.
A.1.4	Where directors have concerns which cannot be resolved about the running of the company or a proposed action, they should ensure that their concerns are recorded in the board minutes. On resignation, a non-executive director should provide a written statement to the chairman, for circulation to the board, if they have any such concerns.	The Society has no comparable mechanism.
A.3 A.3.2	Board Balance Except for smaller companies[2], at least half the board, excluding the chairman should comprise non-executive directors determined by the board to be independent. A smaller Company should have at least two independent non-executive directors	See under A.1.3 above.

2 A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.

Council's report and statement of the Council's responsibilities (continued)

Clause		Comment
A.3.3	The board should appoint one of the independent non-executive directors to be the senior independent director. The senior independent director should be available to shareholders if they have concerns which contact through the normal channels of chairman, chief executive or finance director has failed to resolve or for which such contact is inappropriate.	See under A.1.3 above
D.2	AGM	
D.2.3	The chairman should arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend.	As the Chairs of the Audit and Remuneration Committees are not Members of the Society they are not formally able to speak at the AGM. It is however difficult to envisage circumstances in which the President would not arrange for this if either of the Chairs asked for permission to attend the AGM and speak. (The same would apply to meetings of the Council.)

In relation to the embedding of risk management into the internal control framework, as specified in the Turnbull Guidance to the Combined Code, the Corporate Governance Board has noted continuing progress in 2005, with the need to resume the implementation process which was interrupted by Transition matters in the second half of the year.

Statement of going concern

The Council's opinion is that the Society will have sufficient resources to meet its liabilities as they fall due over the 12 months from the date of signing the accounts. As a result, the Council has satisfied itself that the Society is a going concern.

Office Holders' Report

White Paper on the Regulation of Legal Services

The Government published a White Paper on the regulation of legal services in October 2005. The White Paper sets out the Government's intention to introduce legislation in the next Parliamentary session to establish:

- Legal Services Board (LSB). This new legal regulator will supervise the Law Society, Bar Council and all regulators of legal services. Regulatory functions would be delegated to the front-line regulators subject to their competence and governance arrangements, especially in the separation of regulation from representation. Subject to legislation, it seems likely that the LSB will be established by 2008;
- Office for Legal Complaints. This would be a single independent body to handle consumer complaints against all providers of regulated legal services from 2008. Any discipline and conduct issues about solicitors would continue to be dealt with by the Law Society; and
- Alternative Business Structures (ABSs). These structures would enable lawyers from different professional backgrounds, for example solicitors and barristers, to work together, and would permit non-lawyers to become involved in the management and ownership of legal practices. The Law Society believes that it is well-placed to be front-line regulator of ABSs.

The legislation that will flow from the White Paper will have a significant impact on the Society's structure and future regulatory role. The Society will have to demonstrate competence as a regulator and that it can separate its regulatory and representative functions satisfactorily. The Council has taken significant steps to achieve that separation by establishing new governance structures.

The Society has the statutory power to levy a practising certificate fee, under order of the Master of the Rolls with the concurrence of the Lord Chancellor and the Lord Chief Justice. The Access to Justice Act 1999 defines the uses to which the practising certificate can be put. The Council of the Society is unaware of any intention to revoke the Society's Charter or statutory powers to regulate the solicitors' profession, or for its power to levy a practising certificate fee to be restricted. The implications of the White Paper on the future regulation of legal services have been considered and noted in the Office Holders' Report.

Legal Services Complaints Commissioner

The Government set up the Legal Services Complaints Commissioner (LSCC) in October 2004. The Commissioner has significant powers and is able to make the Society pay a penalty, of up to the lower of £1million or 1% of turnover, if it:

- fails to submit a plan which the Commissioner considers adequate for securing that such complaints are handled effectively and efficiently with it; and
- submits such a plan but fails to handle complaints in accordance with it.

The Society maintained significant improvements in its complaints handling performance throughout 2005. In May 2005 the LSCC confirmed that she found the Society's plan for complaints handling for the year 2005-2006 adequate; but in April 2006, the LSCC indicated that she regarded the plan for year 2006-2007 to be inadequate.

Office Holders' Report (continued)

Law Society Pension Scheme

The Law Society provides a final salary pension scheme for employees who joined before 1 January 2005; for staff joining after that date, the Society contributes to a defined contribution stakeholder pension scheme.

The final salary scheme had a FRS 17 (financial reporting standard) deficit of £44.8m at 31 December 2004.

On 1 June 2005, the Trustees of the Law Society Pension Scheme issued a formal demand to the Society for a £50 million payment into the scheme by the end of December 2005.

In September 2005, the Council agreed that, upon the coming into force of the necessary amendments to the Solicitors Indemnity Rules 1987 that the Society would require that £25 million of the Solicitors Indemnity Fund be released to the Society to be applied towards the demand made by Law Society Pension Scheme Limited under Clause 3(1) of the Deed of Trust governing the Law Society Pension Scheme. This sum was paid over to the Pension Scheme in October 2005.

The Council also decided that, to the extent that there are any funds remaining in the Solicitors Indemnity Fund which are surplus to indemnity requirements at the relevant time, the Society will after 1 October 2006 but before 31 December 2006 further require, under the Solicitors Indemnity Rules 2005, that up to a further £25 million will be released to the Society and will be applied by 31 December 2006 towards the demand made by Law Society Pension Scheme Limited. To the extent that the demand made by the Law Society Pension Scheme Limited remains unsatisfied, the Society will seek a commensurate increase in the practising certificate fee level for 2006/7 to cover such a shortfall.

In addition, the Society will be making a series of top-up payments to the Scheme of £4 million pounds per year for the next five years. This is intended to remove the balance of the Scheme deficit over a 10-year period, taking into account the Trustees' investment strategy. The first £4million was paid over in December 2005.

The Society is reviewing its options for limiting its future exposure to risks arising from the pension scheme, which had a FRS 17 deficit of £36.3 million at 31 December 2005.

Professional Indemnity Insurance

Solicitors Indemnity Fund (SIF) administers the Society's professional indemnity business.

Quasi-subsidiary

In July 2005 the Council of the Law Society directed that up to £50 million be transferred to the Law Society from SIF over a two-year period. The changes to the solicitors indemnity fund rules to allow this transfer came into effect on 1 October 2005. As the Law Society had access to the benefits of SIF from this date, SIF is now a quasi-subsidiary. SIF has been consolidated into the accounts of the Law Society using the acquisition method of accounting.

It is considered to be a discontinued activity as it is now in run-off.

SIF's financial position as at 31 December 2005 shows an accumulated surplus of £11.4 million. Professional indemnity is 'long tail' by nature and estimates suggest that a small number of claims may still need to be dealt with for ten years or more.

Office Holders' Report (continued)

Therefore any release of surplus could only be dealt with over a period of many years.

SIF's Board entered into an Adverse Loss Development Programme (ALDP) underwritten by a leading international reinsurer. This programme provides cover from 1 October 2004 for all the Fund's future claim liabilities up to £205 million. The Fund meets the first £90 million of this programme, the balance being paid by the reinsurer. The effect of this programme allows for a number of uncertainties to be removed, thereby crystallising future surpluses earlier than anticipated.

The Law Society established a working party to determine how any surplus from the Fund should be dealt with. The Solicitors' Indemnity Rules have always provided that all or any part of the Fund not needed for providing indemnity to the profession should be released to the Law Society, but only after the end of what proves to be the final indemnity year.

The Rules have now been amended following a decision taken by the Council of the Law Society on 13 July 2005 to refund the shortfall contributions paid by the profession in the 2001/2 and 2002/3 indemnity periods. These contributions equate to approximately £25 million each (£50 million in total). All remaining surplus is to be dealt with as directed by the Council of the Law Society.

It is intended that the first shortfall contribution refund in respect of the collection made in the 2001/2 financial year be made to the profession by 30 September 2006, with the second refund in respect of the collection made in the 2002/3 financial year to be paid by September 2007.

In October 2005 the Council of the Law Society directed the Fund to pay £25 million of the surplus to the Law Society under Rule 11 of the Solicitors' Indemnity Rules 2005. Is it intended that the Fund will be directed during 2006 to pay to the Law Society a further sum, the amount of which will be dependent upon the financial position of the Fund at the time. This is expected to be paid in late 2006.

In negotiating the ALDP, the Fund was also able to secure post six-year run-off cover for firms that have ceased without successor since 1 September 2000. This will not replace the first six years' run-off cover that firms need to acquire from their qualifying insurers. The cover will be made available for a block period of ten years to commence in September 2007. This will provide continuing run-off protection at no additional cost to those ceased practices beyond the initial six years' protection provided since the open market scheme came into effect on 1 September 2000.

The Fund continues to provide ongoing run-off protection to firms that ceased prior to 31 August 2000.

All the above necessitated a further review of the investment portfolio with the Board preferring a strategy based on gilts providing a matching portfolio to the remaining liabilities of the Fund. These liabilities relate predominately to the £90 million excess payable for future costs of administering the Fund to conclusion. The Board took a decision in late 2004 to exit all equity related investments by 30 September 2005. The balance of the investments was converted to short term deposits to meet the surplus refunds and the payment to the Law Society.

Office Holders' Report (continued)

Board members' attendance records in 2005

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 available to members of the Society on request. Given the Council's size, the records are not shown here.

The attendance records for the Main Board, Finance and Resources Board and the Audit Committee are below.

The Main Board's membership from 1 January 2005 to 31 December 2005 was:

Edward Nally	(President until 14 July 2005)
Kevin Martin+	(President from 14 July 2005, having been Vice-President)
Fiona Woolf+	(Vice-President from 14 July 2005, having been Deputy Vice-President)
Andrew Holroyd+	(Deputy Vice-President from 14 July 2005, having been a Main Board member)
Helen Davies+	
Nigel Day	(from 9 August 2005)
Philip Hamer+	(Treasurer from 18 July 2005)
Richard Hegarty**	
Alexandra Marks+	
Sue Nelson+	
Geoffrey Sandercock	(Treasurer until 17 July 2005)
Rodney Warren+	
Janet Paraskeva*+	(Chief Executive)
Stuart Bushell* (non-voting)	(Director of Regulation, Standards until 28 February 2005, Chair of Transition Board from 28 February 2005)
Alison Crawley* (non-voting)	(Director of Regulation, Compliance)
Evlynne Gilvarry*+ (non-voting)	(Director of Representation and Law Reform)
Frances Low*+ (non-voting)	(Director of Legal Services)
Bruce Minty*+ (non-voting)	(Director of Finance and Resources)
Russell Wallman* (non-voting)	(Director of Strategic Policy; Senior Director Regulation from 28 February 2005)

* denotes members of the Senior Management Team at 31 December 2005.

** non-Council member after 14 July 2005

+ member of the Corporate Governance Board from 1 January 2006

Office Holders' Report (continued)

The membership of the Finance & Resources Board from 1 January 2005 to 31 December 2005 was:

Philip Hamer +	(Chair from 18 July 2005)
Geoffrey Sandercock	(Chair until 17 July 2005)
Robin ap Cynan+	
Michael Franks+	
Bob Heslett+	
John Pickup+	
Peter Williamson	(resigned 14 July 2005)

+ member of the Corporate Governance Board from 1 January 2006.

The membership of the Audit Committee from 1 January 2005 to 31 December 2005 was:

Stephen Brooker	(Chair)
Richard Bagley	
Sue Carter#	(appointed 24 February 2005)
Stuart Collins	(appointed 24 February 2005)
Sunil Kambli	(resigned 3 January 2005)
Michael Lawson	
Geoffrey Mitchell	
Kevin Mortell	
Michael Singleton#	(from 1 September 2005)
Huw Thomas#	(until 31 August 2005)

Council members of the Audit Committee. The remainder are independent members.

The membership of the Remuneration Committee from 1 January 2005 to 31 December 2005 was:

Sally Irvine+	(Chair from 24 February 2005)
Colin Harris+	(Chair until 24 February 2005)
Philip Hamer+	(from 18 July 2005)
Geoffrey Sandercock+	(until 17 July 2005)
Fiona Woolf+	
Ronald Fox	(from 22 September 2005)
Martyn McCarthy	(resigned 31 March 2005)

+ Council members of the Remuneration Committee. The remaining member is independent.

Office Holders' Report (continued)

Attendance records

Main Board			Finance & Resources Board			Audit Committee		
Total number of meetings in 2005	**14**			**6**			**7**	
Helen Davies*	13		Robin ap Cynan*	6		Richard Bagley	6	
Nigel Day*	4	(4)	Michael Franks	5		Stephen Brooker	7	
Philip Hamer*	4	(4)	Philip Hamer*	6		Sue Carter*	6	(6)
Richard Hegarty*	12		Bob Heslett*	6		Stuart Collins	6	(6)
Andrew Holroyd*	11		John Pickup*	5		Sunil Kambli	0	(0)
Alexandra Marks*	8		Geoffrey Sandercock*	4	(4)	Michael Lawson	7	
Kevin Martin*	13		Peter Williamson*	4	(4)	Geoffrey Mitchell	5	
Edward Nally*	10	(10)				Kevin Mortell	4	
Sue Nelson*	14					Michael Singleton*	2	(2)
Janet Paraskeva	14					Huw Thomas*	4	(5)
Geoffrey Sandercock*	9	(10)						
Rodney Warren*+	11							
Fiona Woolf*	12							

* denotes Council members at the time.

The numbers in brackets denote the maximum number of meetings a person could have attended, allowing for the period during which he/she was a Board or Committee member, if less than the full year under review.

+ Rodney Warren was unable to attend some Main Board meetings because of his work on the Society's behalf on the Carter review of the procurement of legal aid services.

The Chief Executive has been included as she is a voting member. Non-voting Senior Management Team members have not been included.

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 on 13 June 2006.

K Martin PRESIDENT

P Hamer TREASURER

Independent auditors' report to the members of the Law Society (the 'Society')

We have audited the consolidated financial statements of the Society for the year ended 31 December 2005 which comprise the consolidated income and expenditure account, consolidated statement of total recognised gains and losses, consolidated balance sheet, consolidated cash flow statement notes to the consolidated cash flow statement and the related notes 1 to 23. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Society's members as a body, in accordance with the bye-laws of the Society. Our audit work has been undertaken so that we might state to the Society's members 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 Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Council and auditors

As described in the statement of Council's responsibilities, the Council, through the Corporate Governance Board (previously the Main Board and the Finance & Resources Board), is responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibility is to audit the financial statements in accordance with relevant United Kingdom 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. We also report if, in our opinion, the Society 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 Council's report for the above year and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

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 Finance & Resources Board in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the group, 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 give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the Society's affairs as at 31 December 2005 and of its surplus for the year then ended.

Deloitte & Touche LLP

Deloitte & Touche LLP

Chartered Accountants

London

14th June 2006

Neither an audit nor a review provides assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular whether any changes may have occurred to the financial information since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area.

Legislation in the United Kingdom governing the preparation and dissemination of financial information differs from legislation in other jurisdictions.

Consolidated income and expenditure account: Year ended 31 December 2005

	Notes	Continuing operations 2005 £'000	Acquisitions of discontinued operations 2005 £'000	Total 2005 £'000	2004 Restated £'000
Income					
Practising certificates and other fees	3	86,836	-	86,836	78,357
Other income	5	21,525	-	21,525	21,583
Grant from The Law Society Charity for educational purposes		-	-	-	1,143
		108,361	-	108,361	101,083
Expenditure					
Administration expenses	6	110,323	-	110,323	100,162
Establishment expenses	6	7,535	-	7,535	7,367
Donation to the Law Society Charity	6	-	-	-	1,000
Donation to the Law Society Bursary Fund	6	135	-	135	58
		117,993	-	117,993	108,587
Investment income and interest	4	1,634	2,085	3,719	2,028
Deficit arising on professional indemnity insurance operations	11	-	(327)	(327)	-
Negative goodwill credited in respect of professional indemnity operations	8	-	30,315	30,315	-
Surplus/(deficit) for the financial year	17	(7,998)	32,073	24,075	(5,476)

Acquisition of discontinued operations relates solely to the activities of the Solicitors Indemnity Fund (SIF).

See page 22 for the reasoning behind the restatement of the figures for 2004.

Consolidated statement of total recognised gains and losses

	2005 £'000	2004 Restated £'000
Surplus/(deficit) for financial year	24,075	(5,476)
Actuarial loss recognised in the pension schemes	(21,102)	
Total recognised gains and losses relating to the year	2,973	(5,476)
Prior year adjustment – funded scheme	(44,841)	
Prior year adjustment – unfunded scheme	(900)	
Total losses recognised since last Annual report	(42,768)	(5,476)

Note of historical cost income and expenditure

	2005 £'000	2004 Restated £'000
Reported surplus/(deficit) for the year	24,075	(5,476)
Unrealised gains on investments recognised in the consolidated income and expenditure account	(1,451)	-
Historical surplus/(deficit) for the year	22,624	(5,476)

Consolidated balance sheet: 31 December 2005

	Notes	2005 £'000	2004 Restated £'000
ASSETS			
Negative goodwill	8	(10,275)	-
Tangible assets	9	56,770	53,216
Investments	10	129,143	-
Reinsurers' share of claims provision	15	33,984	-
Current assets:			
Inventories		298	284
Receivables and prepayments	13	14,279	8,040
Cash and cash equivalents		86,791	68,131
TOTAL ASSETS		310,990	129,671
LIABILITIES			
Current liabilities:			
Creditors	14	(159,560)	(81,069)
Gross claims provisions	15	(106,386)	-
Provision for other liabilities and charges	16	(4,981)	(3,075)
TOTAL LIABILITIES		(270,927)	(84,144)
Total net assets excluding pension liability		40,063	45,527
Pension liability – unfunded		(980)	(900)
Pension liability – funded	20	(36,324)	(44,841)
Total net assets/(liabilities) including Pension Liability		2,759	(214)
Represented by:			
Accumulated Fund	17	2,759	(214)

The financial statements were approved by the Corporate Governance Board of the Law Society on 13 June 2006.

Signed on behalf of the Council of the Law Society

K Martin PRESIDENT

P Hamer TREASURER

Consolidated cash flow statement: Year ended 31 December 2005

	Notes	2005 £'000	2004 Restated £'000
Net cash (outflow)/inflow from operating activities	I	(10,930)	3,903
Returns on investments and servicing of finance	II	1,634	2,028
Taxation		(964)	(791)
Capital expenditure and financial investment	II	(5,778)	(14,108)
Acquisitions and disposals	II	689	-
Cash outflow before management of liquid resources and financing	III	(15,349)	(8,968)
Management of liquid resources	IV	15,309	12,200
(Decrease)/increase in cash in the year	III	(40)	3,232

Consolidated cash flow statement: Year ended 31 December 2005 (Continued)

Reconciliation of net cash flow to movement in net funds

	Notes	2005 £'000	2004 £'000
(Decrease)/increase in cash in the year	III	(40)	3,232
Cash outflow from changes in liquid resources		(15,309)	(12,200)
Change in net funds resulting from cash flows		(15,349)	(8,968)
Deposit accounts and other investments acquired with quasi subsidiary		163,531	-
Net losses on investments		(379)	-
Movement in net funds		147,803	(8,968)
Net funds at 1 January		68,131	77,099
Net funds at 31 December		215,934	68,131

Notes to the consolidated cash flow statement: Year ended 31 December 2005

I Reconciliation of surplus/(deficit) for the year to net cash (outflow)/ inflow from operating activities

	2005 £'000	2004 Restated £'000
Surplus/(deficit) for the year	24,075	(5,476)
Depreciation charges	10,971	7,383
Movement in provision for professional indemnity insurance run-off costs	(287)	-
Decrease in professional indemnity insurance claims incurred net of reinsurance	(8,731)	-
Loss on disposal of tangible fixed assets	1,643	54
Investment income received	(7)	(6)
Bank deposit interest received	(1,627)	(2,022)
Tax charge	869	975
Increase in stocks	(14)	(16)
Decrease/(increase) in debtors	1,750	(738)
Increase/(decrease) in creditors	4,666	(743)
Increase in fees in advance	18,313	4,976
Increase in pension fund	(32,614)	(484)
Net realised and unrealised losses on investments	378	
Release of negative goodwill	(30,315)	-
Net cash (outflow)/inflow from operating activities	(10,930)	3,903

II Analysis of cash flows for headings netted in the cash flow statement

	2005 £'000	2004 £'000
Returns on investments and servicing of finance		
Bank deposit interest received	1,627	2,022
Investment income received	7	6
Net cash inflow from returns on investments and servicing of finance	1,634	2,028
Capital expenditure and financial investment		
Purchase of tangible fixed assets	(5,778)	(14,108)
Net cash outflow from capital expenditure and financial investment	(5,778)	(14,108)
Acquisitions and disposals		
Cash acquired with quasi subsidiary	689	-
Net cash acquired from acquisitions and disposals	689	-

Notes to the consolidated cash flow statement: Year ended 31 December 2005 (continued)

III Analysis of net funds

	At 1 January 2005 £'000	Cash flow £'000	Acquisitions £'000	Other non-cash items £'000	At 31 December 2005 £'000
Cash in hand and at bank	5,331	(40)	-	-	5,291
Cash held in deposit	62,800	18,700	-	-	81,500
Cash investments	-	(17,110)	94,903	-	77,793
Other investments	-	(16,899)	68,628	(379)	51,350
	68,131	(15,349)	163,531	(379)	215,934

IV Management of liquid resources

	2005 £'000	2004 £'000
Cash withdrawn from deposit accounts	15,309	12,200

Notes to the accounts: Year ended 31 December 2005

1. Accounting policies

The financial statements are prepared in accordance with applicable United Kingdom law and accounting standards but not in accordance with the full requirements of the Companies Act 1985. The particular accounting policies adopted are described below and these have been applied consistently in the current and prior year.

The financial statements are prepared under the historical cost convention with the exception of valuation of investments and claims provisions (see below).

Basis of preparation

Following the decision of the Council of the Law Society in June 1999 to move to market insurance, the professional indemnity insurance operations went into run-off on 1 September 2000. On 4 October 2005 the Solicitors Indemnity Fund (SIF) became a quasi subsidiary of the Law Society due to a change in solicitors indemnity fund rules. Consequently, in order to comply with FRS3 (Reporting Financial Performance) it is necessary to report the acquisition of the fund in the consolidated accounts. The professional indemnity insurance operations had ceased and are therefore treated as discontinued activities. Under FRS3 it is also necessary to provide for all future anticipated administration costs, which are referred to as run-off costs.

Accrued interest has been re-classified in the Balance sheet to other debtors which is considered a more appropriate classification. This has not had any impact on the results.

Change in accounting policies

The Society has adopted Financial Reporting Standard 17 Retirement Benefits (FRS 17) in these financial statements. The new accounting policy is given below 'Pension Costs'. The adoption of this standard represents a change in accounting policy and the comparatives have been restated accordingly. Details of the effect of adopting this accounting policy are given in Note 17.

Basis of consolidation

Consolidated entities

The consolidated financial statements include the financial statements of the Law Society, together with those of The Law Society Services Limited, The Law Society Property Services Limited, Solicitors' Indemnity Fund, The Law Society Pension Scheme Limited, Law Society (Hardware Rental Services) Limited and Law Society (Software Licensing Services) Limited, which are wholly owned by the Law Society.

The Society's 51% holding in Solicitors' Professional Indemnity Limited (SPIL #2), a dormant company, is included in the consolidated accounts of the Society.

In July 2005 the Council of the Law Society directed that up to £50 million be transferred to the Law Society from SIF over a two-year period. The changes to the solicitors indemnity fund rules to allow this transfer came into effect on 1 October 2005. As the Law Society had access to the benefits of SIF from this date, SIF is now a quasi-subsidiary. SIF has been consolidated into the accounts of the Law Society using the acquisition method of accounting.

Notes to the accounts (continued)

Non-consolidated entities

A review was undertaken in November 2005 (and agreed at January 2006 Corporate Governance Board meeting) to consider if consolidation was appropriate. It was agreed that the following entities should not be consolidated into the financial statements of the Law Society: Compensation Fund, Stannard Bequest Fund, The Law Society Retirement Benefits Scheme, The Cheviot Trust, The Law Society Trustees Limited, The Law Society Charity, The Law Society Pension Scheme and the Assigned Risks Pool.

These entities are not consolidated in the consolidated Society financial statements because the Law Society does not exercise control over these entities.

Practising Certificates

Fees received in respect of practising certificates for the practising year which commences on 1 November are apportioned over the practising certificate period to which they relate. No credit has been taken for fees due but not received at the balance sheet date, since there is no certainty that these will be paid.

Examination fees and Legal Practice Course fees

Examination fees are accounted for in the year in which the examination is held. Legal Practice Course fees are apportioned over the period of the course to which they relate.

Admission, annual enrolment, registration and transfer of training contracts

These fees are accounted for on a cash received basis.

Students' enrolment fees

These fees are payable on registration and are apportioned over the period to which they relate.

Taxation

Full provision is made for taxation payable on activities during the year. The Law Society is only liable for taxation on its investment income and gains and obtains no tax relief for its overhead expenditure, which is regarded as being incurred for the benefit of members whose fees are correspondingly not taxed. Tax relief is obtained on annual payments made under deed of covenant and Gift Aid. Its subsidiaries, The Law Society Services Limited and The Law Society Property Services Limited, are liable for corporation tax on their profits.

Deferred taxation

Deferred taxation is recognised in respect of all timing differences (except those noted as exceptions in the accounting standard) that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more, or a right to pay less, tax in the future have occurred at the balance sheet date. Deferred tax assets are recognised only to the extent that it is more likely than not that there will be taxable profits from which the future reversal of the underlying timing differences can be deducted.

Depreciation of fixed assets

Tangible fixed assets are stated at cost net of depreciation and any provision for impairment.

Notes to the accounts (continued)

Depreciation is provided on a straight-line basis to write off the cost less estimated residual value over the periods indicated below:

(i) In respect of freehold property which has been split into various component parts with each category being depreciated over its useful economic life as follows, or straight line over 50 years:

Building structure	50 years
Internal finishes	15 years
Services and fittings	25 years
External works	35 years

Costs of repairs and maintenance are charged against revenue in the year in which they are incurred.

(ii) In respect of leasehold property and improvements:

Premiums paid – over the period to the next open market rent review

Improvements – over ten years or the period of the lease if shorter

(iii) In respect of equipment and furniture:

Motor vehicles: over five years

Equipment and furniture: over ten/five/four years

(iv) In respect of computers and hardware:

Mainframe, mini computers, servers and operating software: over five years

Software associated with the Society's Customer Relationship Management and web systems is being written off over five years from the point at which the relevant software is first used.

All other computing equipment and software: over three/four years.

All additions to the library are now written off in the year of purchase.

No depreciation is charged on freehold land.

Goodwill

Goodwill arising on an acquisition of a subsidiary undertaking is the difference between the fair value of the consideration paid and the fair value of the assets and liabilities acquired. Negative goodwill has arisen on the acquisition of Solicitors Indemnity Fund, as no consideration was paid for monetary and non-monetary assets. Upon consolidation of the monetary assets acquired, this negative goodwill has been written off to reserves, through the Consolidated Income and Expenditure Account.

Valuation of investments

All investments, which relate to professional indemnity insurance activities, comprise deposit accounts and fixed interest stocks held by Merrill Lynch on behalf of the Group. Fixed interest stocks are valued at their mid-market value at the balance sheet date. As these funds are held to meet long term liabilities, they are classified as fixed asset investments.

Notes to the accounts (continued)

Investment income

Interest on Government stocks, bonds and deposits has been accounted for on an accruals basis. All other investment income has been taken into account on the basis of the due date.

Stocks

Stocks are valued at the lower of cost and net realisable value.

Contributions

Professional Indemnity Insurance contributions are accounted for on the accruals basis.

Claims paid

Professional Indemnity Insurance claims are accounted for as and when payment is authorised. They include the cost of panel solicitors and the cost of internal claims handling staff, including an appropriate share of overheads.

Claims provisions

Estimation techniques are used to determine the Gross Claim Provision of Professional Indemnity Insurance activities which represent the estimated outstanding liabilities relating to all indemnity years.

Ultimate claim settlements are estimated by the use of statistical projections of historical data, together with case reviews of notified losses, and are based on information available at the time the estimates are made. There is uncertainty as to the quantum of the ultimate settlement of the liabilities which is inherent in the process of estimating such that, in the normal course of events, unforeseen or unexpected future developments cause the ultimate cost of settling outstanding liabilities to differ from that currently estimated. Any differences between provisions and subsequent settlements are dealt with in later accounting periods. Claims provisions include the estimated costs of panel solicitors and internal claims handling staff, including an appropriate share of overheads.

Claims provisions are discounted to take account of future investment income which will be earned on the assets held for meeting claims. It is considered appropriate to discount claims provisions because contributions to the Fund were determined after taking account of future investment income. The discount is calculated using the rate of interest which corresponds to the Fund’s estimated long term rate of investment return and an estimate of the time to settlement based on the historic trend.

The gross claim provision has been calculated in accordance with the insurance SORP.

Lease transactions

Rentals under operating leases are charged to the income and expenditure account in equal annual amounts over the lease term.

Development costs

Software development expenditure is capitalised if it is separately identifiable, it is reasonably certain that the development will be successful and, on completion, it will provide a material benefit to the Society.

Notes to the accounts (continued)

Pension costs

The Council of the Law Society decided to close the existing Law Society pension scheme to new members from 1 January 2005. From that date, a new pension scheme has been set up whereby new or current staff who have not joined the existing scheme within 12 months of commencing employment are now eligible to join this new scheme, which will be a Defined Contribution (Money Purchase) scheme.

Pension costs (continued)

The Law Society will also contribute towards this new scheme, which will be double the individual employee's contribution up to maximum of 7% of basic salary.

A separate defined contribution pension scheme is also available to staff involved in the professional indemnity insurance operations.

For defined benefit schemes, the amounts charged to the income and expenditure account are the current service costs and gains and losses on settlements and curtailments. Past service costs are recognised immediately in the income and expenditure account if the benefits have vested. If the benefits have not vested immediately, the costs are recognised over the period until vesting occurs. The interest cost and the expected return on assets are shown as a net amount of other finance costs or credits. Actuarial gains and losses are recognised immediately in the statement of total recognised gains and losses.

Pension – funded

Defined benefit schemes are funded, with the assets of the scheme held separately from those of the group, in separate trustee-administered funds. Pension scheme assets are measured at market value and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high-quality corporate bond of equivalent currency and term to the scheme liabilities. The actuarial valuations are obtained at least annually and are updated at each balance sheet date. The resulting defined benefit asset or liability, net of the related deferred tax, is presented separately after other net assets on the face of the balance sheet.

Pension – unfunded

The unfunded scheme (also referred to as ex-gratia or top-up scheme) was implemented by the Law Society in the 80s when inflation was running very high. Under the scheme the Society agreed to top up/increase pensioners' payments to account for the erosion of the value of pensions.

A monthly payment is made by the Society to Legal and General (L&G) and L&G in turn pay this money to the pensioners. The amounts payable are reviewed regularly by Cheviot and 'valued' each year by a qualified actuary. Any change in value of the scheme is charged to the Society and included in the financial statements.

For defined contribution schemes the amount charged to the income and expenditure statement in respect of pension costs and other post-retirement benefits is the contribution payable in the year. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

Notes to the accounts (continued)

2. Segmental analysis

	Income		Surplus/(deficit) for the financial year		Net assets / (liabilities)	
	2005 £'000	2004 £'000	2005 £'000	2004 Restated £'000	2005 £'000	2004 Restated £'000
Analysis by class of business						
Law Society activities	108,361	103,111	(7,998)	(5,476)	(4,313)	(214)
Professional indemnity operations	-	-	32,073	-	7,072	-
	108,361	103,111	24,075	(5,476)	2,759	(214)

3. Practising certificates and other fees

	2005 £'000	2004 Restated £'000
Practising certificates	82,213	73,817
Examination and Legal Practice Course Fees	2,042	1,962
Admission fees	729	715
Student enrolment fees	806	828
Annual enrolment fees	425	407
Registration and transfer of training contracts	621	628
	86,836	78,357

4. Investment income and interest

	2005 £'000	2004 Restated £'000
Bank deposit interest	1,627	2,022
Investment income	7	6
Equities	90	-
Fixed interest and deposits	1,941	-
Interest on payments into court	54	-
	3,719	2,028

Notes to the accounts (continued)

5. Other income

	2005 £'000	2004 Restated £'000
Gazette income from advertisements	9,002	9,508
Publications and products	1,698	1,875
Courses and functions	854	519
National conference	860	270
Recruitment service	96	136
Library	151	175
Rents receivable	329	327
Royalty income	743	802
Grant income	624	972
Catering	394	455
Foreign lawyer registration	1,500	1,558
Special interest sections income	770	619
Family Law Panel fees	234	218
Countrywide legal indemnity	424	401
Personal Injury Panel	160	162
Authorisation of Course Providers	620	729
Business services to solicitors	828	818
Other subscriptions	116	121
Sundry income	2,122	1,918
	21,525	21,583

Notes to the accounts (continued)

6. Analysis of expenditure

		2005 £'000	2004 Restated £'000
Administration expenses			
Employment costs:	wages and salaries	47,302	40,605
	social security costs	4,183	3,562
	other pension costs	4,764	7,788
	other costs	4,785	6,007
Recoveries of administration expenses from the Compensation Fund		(11,638)	(9,679)
Other recoveries		(97)	(109)
		49,299	48,174
Gazette – printing paper and postage		2,711	2,714
Other printing and stationery		1,947	2,173
Other postage and telephone		2,470	2,601
Computer charges		5,934	6,685
Office holders' expenses		343	367
Council and committee expenses		1,261	1,235
Staff travelling and other expenses		2,551	2,745
Legal fees		8,274	6,683
Auditors' remuneration		151	109
Other professional fees		8,661	7,550
Operating lease costs		921	811
General administration expenses		6,272	4,745
Loss on disposal of fixed assets		1,643	54
Depreciation – equipment and furniture and computer hardware		9,963	6,405
Value Added Tax irrecoverable		5,846	5,418
Financial services – application and registration fees		263	226
Legal Services Complaints Commission		1,350	404
Solicitors' Disciplinary Tribunal expenses		86	88
Taxation		377	975
		110, 323	100,162
Establishment expenses			
Rent, rates, heating, cleaning and insurances		3,435	3,353
Operating lease costs		1,716	1,467
Repairs and alterations		1,235	1,399
Employment costs:	wages and salaries	602	590
	social security costs	45	46
	other pension costs	102	85
Depreciation – property		973	978
		8,108	7,918
Recoveries of establishment expenses from the Compensation Fund		(573)	(551)
		7,535	7,367

Notes to the accounts (continued)

6. Analysis of expenditure (continued)

In addition to their remuneration as auditors, as set out above, Deloitte & Touche LLP were also paid £1,556,000 (2004: £3,355,000) in respect of the following matters:

Non audit fees	**2005 £'000**	**2004 £'000**
Tax services:		
compliance services	31	22
advisory services	48	24
Other services:		
litigation assistance	-	60
project management & implementation services	1,435	2,918
IT outsourcing	39	185
other services not covered above	3	146
	1,556	3,355

Tax advisory services include work in relation to VAT advice and assistance, and income tax advice and assistance given during the year.

During the year Deloitte & Touche LLP continued their work in relation to the ongoing assessment of Programme Engineer, as well as the project management of Programme Engineer.

Other services include work in relation to the support of the International directorate.

Of the £1,556,000 fees shown above, £1,000 (2004: £62,000) was recharged to the Compensation Fund and £1,435,000 (2004: £2,918,000) capitalised.

This additional remuneration is included in other professional fees and legal fees.

Ernst & Young LLP continued their Programme Engineer assurance work in 2005.

Donation to The Law Society Charity

The donation to the Law Society Charity for 2005 was £nil (2004: £1,000,000). No donation for 2005 was made from the Law Society Services Limited (2004: £nil) under Gift Aid.

Donation to The Law Society Bursary Fund

The Law Society Education and Training Department made a Gift Aid donation of £135,000 (2004: £58,000) to the Law Society Bursary Fund for the benefit of students.

Notes to the accounts (continued)

7. Compensation, remuneration and staff numbers

Office holders

Compensation for the year was payable in respect of the office holders as follows:

	2005 £	2004 £
President	91,668	89,284
Vice-President	45,834	44,642
Deputy Vice-President	22,917	22,321

From 1 September 2005 the annual compensation payable was increased in respect of office holders as follows:

	£
President	93,483
Vice-President	46,742
Deputy Vice-President	23,371

The Lay Commissioner received total emoluments of £101,948 during the year ended 31 December 2005 (2004: £114,637). The Lay Commissioner's term ended on 31 October 2005.

Compensation in respect of lay members serving on the Adjudication Panel is £4,000 per annum, in respect of those serving on the Compliance Board is £3,000 per annum and in respect of those serving on the Council is £3,000 per annum.

Senior Management Team ("SMT")

The SMT of the Society received total emoluments, including pension contributions, of £1,570,000 for the year to 31 December 2005 (2004: £1,408,000).

The highest paid member, being the Chief Executive, received emoluments including pension contributions of £338,000 (2004: £297,000). This figure includes basic salary of £196,000, bonus of £38,000 (relating to 2004) and pension contribution of £94,000 including employer's contributions.

All SMT members are members of the Law Society Pension Scheme in both the current and prior years.

Staff numbers (full-time equivalents at year end)

The average number of persons employed by the Society for the year ending 31 December 2005 was 1,374 (2004: 1,297).

Notes to the accounts (continued)

8. Negative goodwill

	£'000
Cost	
Arising on acquisition and at 31 December 2005 (see note 23)	40,590
Amortisation	
Credit for the year and at 31 December 2005	30,315
Net book value	
At 31 December 2005	10,275

Negative goodwill at 31 December 2005 represents the fair value of land and buildings acquired on the acquisition of Solicitors Indemnity Fund Limited – see note 23. This goodwill will be credited to the consolidated income and expenditure account when the land and buildings are sold. Since the year end, contracts have been exchanged to sell the land and buildings for £10.275 million.

The amortisation credit for the year relates to the acquisition of monetary assets for nil consideration. As the group has the benefit of these assets on acquisition, the related goodwill has been credited to the consolidated income and expenditure account immediately.

9. Tangible assets

	Freehold land and buildings £'000	Leasehold property & improve-ments £'000	Equipment and furniture £'000	Computers and hardware £'000	Total £'000
Cost					
At 1 January 2005	30,542	412	16,970	54,101	102,025
Reclassification	-	-	27	(27)	-
Additions	-	129	729	4,920	5,778
Acquisitions	10,275	-	464	1,170	11,909
Disposals	-	-	(1,789)	(4,704)	(6,493)
At 31 December 2005	40,817	541	16,401	55,460	113,219
Accumulated depreciation					
At 1 January 2005	9,139	146	7,232	32,292	48,809
Reclassification	-	-	3,053	(3,053)	-
Acquisitions	-	-	444	1,075	1,519
Charge for the year	841	152	1,505	8,473	10,971
Disposals	-	-	(1,687)	(3,163)	(4,850)
At 31 December 2005	9,980	298	10,547	35,624	56,449
Net book value					
At 31 December 2005	30,837	243	5,854	19,836	56,770
At 31 December 2004	21,403	266	9,738	21,809	53,216

Notes to the accounts (continued)

Freehold land and buildings are periodically valued. The total open market value at the last valuation in 2005 was £35,025,000.

The Library collection, which has a net book value of £nil (2004: £nil) is shown within equipment and furniture. It is periodically valued for insurance purposes. The last valuation in 2005 totalled £3,297,000.

10. Investments

	Current value 2005 £'000	Current value 2004 £'000
Fixed interest stocks	51,350	-
Deposits	77,793	-
	129,143	-

11. Subsidiary and other undertakings

The Society had the following subsidiary undertakings. They are all incorporated in Great Britain and operate in England and Wales.

	Nature of business	Issued share capital	Percentage of Ownership
The Law Society Services Limited	Trade and services	£100	100%
The Law Society Property Services Limited	Property holding company	£100	100%
The Law Society Trustees Limited	Charity trustee	Limited by guarantee	100%
The Law Society Pension Scheme Limited	Pension trustee	Limited by guarantee	100%
Law Society (Hardware Rental Services) Limited	Lease rental (dormant)		100%
Law Society (Software Licensing Services) Limited	Lease rental (dormant)		100%
Queens Counsel Appointment Limited	Services and Support	Limited by guarantee	100%
Solicitors Indemnity Fund Limited	Professional Indemnity Insurance	Limited by guarantee	100%
Solicitors Indemnity Fund	Professional Indemnity Insurance	Fund	100%
Solicitors Indemnity Fund Operations Limited	Professional indemnity insurance	£100	100%

Notes to the accounts (continued)

The Law Society Pension Scheme Limited, Law Society (Hardware Rental Services) Limited and Law Society (Software Licensing Services) Limited and Queens Counsel Appointment Limited have no, or minimal, assets or liabilities.

The Solicitors' Indemnity Fund Limited (SIF) is considered to be a quasi-subsidiary (see note 1) under the terms of financial reporting standard 5 (FRS 5) and its assets and liabilities are consolidated in these financial statements.

The summarised financial statements of SIF are:

	(post acquisition) 3 month period ended 31 December 2005 £'000	(pre-acquisition) 12-month period ended 30 September 2005 £'000
Revenue account		
Gross claims paid	(8,827)	(42,489)
Reinsurance recoveries	657	932
Decrease in gross provision for reclaims	13,654	56,285
(Decrease)/increase in amount recoverable from reinsurers	(4,923)	38,904
Decrease in insurance claims incurred net of reinsurance	561	53,632
Reinsurance premiums payable	-	(40,856)
Investment return	1,684	12,248
Administration expenses	6	(782)
Contributions refunds	(3)	(50,362)
Tax (charge)/credit	(490)	5,840
Surplus/(deficit) after tax	1,758	(20,280)

There are no other recognised gains or losses for the year.

The surplus shown above is recorded in the group accounts as follows:

	3 Month period ended 31 December 2005 £'000
Surplus recognised in the income and expenditure account as:	
- investment income and interest	2,085
- deficit arising on professional indemnity insurance operations	(327)
	1,758

Notes to the accounts (continued)

The summarised financial statements of SIF are (continued):

Administrative expenses are broken down as follows:

	3 month period ended 31 December 2005 £'000	12-month period ended 30 September 2005 £'000
Staff	851	3,435
Premises	147	537
Computer	150	608
Legal and professional	39	454
Audit	62	63
Management charges	-	5
Insurance	54	259
Depreciation	35	218
Other operating costs	69	306
Total operating expenditure in the period	1,406	5,885
Less cost of internal claims-handling staff, including share of overheads	(1,125)	(4,708)
Administrative expenditure in the period	281	1,177
Movement in provision for run-off costs (note 16)	(287)	(395)
(Credit)/charge to revenue account in the period	(6)	782

The provision for run-off costs represents future anticipated administration costs as set out in the accounting policies. The cost of internal claims handling staff, including an appropriate share of overheads has been included in claims paid as described in the accounting policies.

Notes to the accounts (continued)

The summarised financial statements of SIF are (continued):

Balance Sheet

	(Post-acquisition) 31 December 2005 £'000	(Pre-acquisition) 30 September 2005 £'000
Assets		
Investments	129,143	163,531
Reinsurers' share of claims provision	33,984	38,907
Debtors	7,505	7,883
Fixed assets	4,019	4,054
Bank balances	3,491	689
Total assets	178,142	215,064
Liabilities		
Gross claims provision	106,386	120,040
Provision for other liabilities and charges	4,981	5,657
Creditors	55,764	80,113
Total liabilities	167,131	205,810
Net assets	11,011	9,254

Cashflow statement

	(Post-acquisition) 3 months ended 31 December 2005 £'000	(Pre-acquisition) 12 months ended 30 September 2005 £'000
Net cash flow from operating activities	(31,207)	(70,031)
Cash expenditure	-	(43)
Net cash outflows	(31,207)	(70,074)

Notes to the accounts (continued)

12. Joint ventures

a) SPIL

On 25 April 2000 the Society entered into a joint venture agreement with St. Paul Holdings Limited (St Paul). In accordance with this agreement, a joint venture company, Solicitors Professional Indemnity Limited – SPIL#1 (the 'joint venture Company'), was set up for the following purposes: to arrange the provision of compulsory professional indemnity insurance to solicitors in private practice in England and Wales under the new open market arrangements; to act as marketing, claims handling and underwriting agent of St. Paul International Insurance Company Limited in respect of solicitors' professional indemnity insurance; and to provide run-off and related services to the Solicitors Indemnity Fund.

During the year ended 31 December 2002, St. Paul Holdings Limited transferred its shareholding to St. Paul Co. Inc who subsequently transferred it to St. Paul London Limited.

The Law Society owned 51 'A' shares and St Paul owned 49 'B' shares in SPIL#1.

The agreement with St Paul was terminated on 30 September 2004.

The Law Society was approached by St Paul with an offer to enter a new joint venture agreement but under this agreement St Paul would not manage and administer the run-off of SIF.

The carve-out of the management of the run off of SIF was achieved by the shares in SPIL#1 being transferred from each of the Law Society and St Pauls to Solicitors Indemnity Fund Limited on 1 October 2004. The Law Society gave no warranties or indemnities in respect of the 'A' shares and received £51 from SIF Limited in consideration for the transfer.

The Law Society entered into a number of agreements relating to SPIL#2 on 1 October 2004. The arrangements largely mirror the agreements which were in place on the previous joint venture, but crucially, the difference between SPIL#1 and SPIL#2 is that SPIL#2 will not operate and will remain effectively dormant unless and until St Paul group fails to offer quotations for compulsory professional indemnity insurance to the profession (trigger event). .

b) Queen's Counsel Appointment

A joint venture company with the Bar Council, Queen's Counsel Appointment (limited by guarantee and not having a share capital) was incorporated on 13 April 2005. The main purpose is to support and facilitate the process for the selection and appointment of Queen's Counsel (or King's Counsel), and to support the independent Selection Panel charged with the conduct of that process, and thereby to assist the process in serving the public interest by offering a fair and transparent means of identifying excellence in advocacy in the higher courts.

Notes to the accounts (continued)

13. Receivables and prepayments

	2005 £'000	2004 £'000
Trade debtors	2,879	3,076
Grant receivable from The Law Society Charity	-	1,143
Compensation Fund	391	685
Other Law Society affiliated entities	329	306
Other debtors	1,754	955
Prepayments	1,587	1,875
Corporation tax recoverable	107	-
Excess of loss insurance recoveries	119	-
Claims recoveries receivable	5	-
Accrued income	946	-
Reinsurance premiums recoverable	5,340	-
Claims recoverable under master policies	49	-
VAT	773	-
	14,279	8,040

14. Creditors

	2005 £'000	2004 £'000
Amounts due to suppliers	16,323	11,322
Other creditors including taxation and social security	1,220	1,807
Fees received in advance	86,253	67,940
Accrued expenses	844	-
Contributions refundable	50,223	-
Stop loss insurance recoveries payable	132	-
Excess of loss insurance recoveries payable	492	-
Income tax	3,804	-
Claims payable	195	-
Claims payable under master policy	74	-
	159,560	81,069

Included in other creditors are balances of £1,299,000 (2004 £1,147,000) in respect of PAYE and National Insurance.

Notes to the accounts (continued)

15. Claims provision

	2005 Gross £'000	2005 Reinsurance £'000	2005 Net £'000	2004 Net £'000
Total provision	114,683	(37,728)	76,955	-
Discount adjustment	(8,297)	3,744	(4,553)	-
Provision at discounted value	106,386	(33,984)	72,402	-
Provision acquired (see note 23)	120,040	(38,907)	81,133	-
Release of the provision to income and expenditure account	(13,654)	4,923	(8,731)	-

The professional indemnity insurance claims provisions have been discounted using the long term discount rate of investment return of 3% (2004: 3%)

16. Provisions for liabilities and charges

	Provision for run-off costs £'000	Provision for deferred tax £'000	Other provisions £'000	Total £'000
As at 1 January 2005	-	-	3,075	3,075
Acquisitions (see note 23)	4,161	1,496	-	5,657
Released in year	(287)	(389)	(3,075)	(3,751)
As at 31 December 2005	3,874	1,107	-	4,981

Provision for deferred tax is made up as follows:

	2005 £'000	2004 £'000
Mark-to-Market transitional adjustment	1,184	-
Other timing differences	(77)	-
	1,184	-

The provision for run-off costs represents future anticipated administration costs in respect of the professional indemnity insurance operations. The cost of the internal claims-handling staff, including an appropriate share of overheads, has been included in claims paid, as described in the accounting policies note.

Deferred tax has not been provided on the revaluation or freehold land and buildings (see note 23) as the Group had not entered into a binding agreement to sell this asset before the year end. Should this asset be sold for this revalued amount then it is estimated that income tax of between £500,000 and £750,000 will become payable.

Notes to the accounts (continued)

17. Accumulated fund

	Accumulated fund £'000 2005	Accumulated fund £'000 2004
Consolidated		
At 1 January 2005 as previously stated	45,527	51,003
Prior year adjustment (FRS 17)		
- funded scheme	(44,841)	(44,841)
- unfunded scheme	(900)	(900)
At 1 January 2005 as restated	(214)	5,690
Surplus/(loss) for the financial year	24,075	(5,476)
Actuarial loss recognised in the pension schemes	(21,102)	-
At 31 December 2005	2,759	214
The Law Society		
At 1 January 2005	42,000	48,416
Prior-year adjustment (FRS 17)		
- funded scheme	(44,841)	(44,841)
- unfunded scheme	(900)	(900)
At 1 January 2005 as restated	(3,741)	2,675
Surplus for the financial year	17,484	(6,416)
Actuarial loss recognised in the pension schemes	(21,102)	-
At 31 December 2005	(7,359)	(3,741)

18. Operating lease commitments

The Society's commitments for rental payments under operating leases payable during the year to 31 December 2005 are as follows:

	Land and buildings		Other operating leases	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Leases expiring between two and five years	397	534	921	821

Notes to the accounts (continued)

19. Capital commitments

The Main Board agreed Programme Engineer (mostly Customer Relation Management system and WEB) capital expenditure of £3,403,250 (2004: £8,648,000) of which £3,086,490 (2004: 5,816,000) has been spent on the Programme up to the end of December 2005 with no further expenditure due in 2006.

20. Pension commitments

The Society operates a pension scheme (the 'Scheme') providing benefits based upon final pensionable salary. The assets of the Scheme are held separately from those of the Society in a trustee administered scheme, The Law Society Pension Scheme. These assets are invested mainly in quoted securities and are managed by Merrill Lynch Investment Managers Limited, Barclays Global Investors Limited and Bank of Ireland Asset Management UK Limited.

The total pension cost for the year was £9,358,000 (2004: £9,858,000).

The deficit decreased from £44.8 million to £36.3 million (see page 43). The Law Society has made a commitment to the Pension scheme to pay an additional £25 million by December 2006 and four further instalments of £4 million each for the next four years.

Other pensions

The Society also operates a defined contribution scheme providing benefits based on the amounts paid into the scheme and the performance of the investments.

The scheme incurred costs of £133,000 during the year (2004: £nil).

There were no outstanding prepaid or accrued contributions at the year end.

In addition, a separate defined contribution pension scheme is available to staff involved in the professional indemnity insurance operations. The scheme incurred costs of £53,000 during the year (2004:£nil). There were no outstanding prepaid or accrued contributions at the year end (2004: £nil).

FRS Retirement benefits

The Scheme is subject to triennial valuation by a qualified independent actuary.

The full actuarial valuation of the Scheme was carried out as at 31 October 2005 by a qualified, independent actuary. The valuation was updated to 31 December 2005 for FRS17 purposes. The scheme is closed to new entrants, under the projected unit method the current service cost will increase as the members of the scheme approach retirement.

Notes to the accounts (continued)

20. Pension Commitments (continued)

The assets in the scheme and the expected rates of return at 31 December were:

	2005		2004		2003	
	Long term rate of return expected	Value £'000	Long term rate of return expected	Value £'000	Long term rate of return expected	Value £'000
Equities	7.1%	58,136	7.8%	44,188	7.8%	35,908
Bonds	4.1%	79,955	4.8%	40,327	4.8%	33,345
Total market value of assets		138,091		84,515		69,253
Present value of Scheme liabilities		(174,415)		(129,356)		(112,308)
Deficit in the scheme and net pension liability		(36,324)		(44,841)		(43,055)

Notes to the accounts (continued)

20. Pension Commitments (continued)

The figures shown above were calculated on the basis of the following assumptions.

	2005	2004	2003
Discount rate	4.8%	5.3%	5.4%
Rate of increase in salaries	4.2%	4.85%	4.75%
Rate of increase in deferred pensions	2.7%	2.85%	2.75%
Rate of increase in pensions in payment (for pensions accrued before 1 November 2002)	5.0%	5.0%	5.0%
Rate of increase in pensions in payment (for pensions accrued after 1 November 2002)	2.7%	2.85%	2.75%
Inflation assumption	2.7%	2.85%	2.75%

Analysis of the movements in the scheme deficit during the year

	2005 £'000	2004 £'000
Opening deficit in the scheme and net pension liability	(44,841)	(43,055)
Current service cost	(7,664)	(7,293)
Normal contributions	9,824	7,626
One off contribution	25,000	-
Annual contribution	4,000	-
Past service cost	(373)	(1,018)
Other finance income	(1,168)	(1,648)
Actuarial (loss) / gain	(21,102)	547
Closing deficit in the scheme and net pension liability	(36,324)	(44,841)

Amounts that have been included within the financial statements for the year ended 31 December 2005 are as follows:

Amounts included within operating profit

	2005 £'000	2004 £'000
Current service cost	7,664	7,293
Past service cost	373	1,018
Total operating charge	8,037	8,311

Notes to the accounts (continued)

20. Pension Commitments (continued)

Amounts included as net finance return

	2005 £'000	2004 £'000
Expected return on scheme assets	5,861	4,627
Interest on scheme liabilities	(7,029)	(6,275)
Net return	(1,168)	(1,648)

Analysis of the actuarial (loss)/gain in the statement of total recognised gains and losses

	2005 £'000	2004 £'000	2003 £'000	2002 £'000
Actuarial return less expected return on pension scheme assets				
Amount (£'000)	10,006	3,524	3,221	(10,315)
Percentage of scheme assets	7%	4%	5%	(18%)
Experience (losses)/gains/arising on the scheme liabilities				
Amount (£'000)	(4,018)	1,184	3,065	(4,383)
Percentage of net present value of scheme liabilities	(2%)	1%	3%	(5%)
Changes in assumptions underlying the present value of the scheme liabilities	(27,090)	(4,161)	(12,384)	(12,276)
Total actuarial (losses)/gains recognised in the statement of total recognised gains and losses				
Amount (£'000)	(21,102)	547	(6,098)	(26,974)
Percentage of the present value of scheme liabilities	(12%)	0%	(5%)	(29%)

Notes to the accounts (continued)

21. Monies held as a consequence of the intervention process

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. A response was received on 9 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 grant 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.

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.

At 31 December 2005, £55.7 million (2004: £44.6 million) 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 a few cases may never be known.

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

Interim payments to the Fund have been authorised and made pursuant to rights of subrogation in January/February 2005. A total of £3.1 million was paid to the Compensation Fund in the year (2004: £0.7 million).

22. Related party transactions

Four lay members of the Council received payments of £3,000 each in 2005 (there were five lay members who received £3,000 in 2004). The Lay Commissioner’s emoluments are set out in note 7.

The Law Society paid £17,957 (2004: £195,228) excluding VAT to Council members in respect of royalties received, assessors’ fees and training.

Notes to the accounts (continued)

23. Acquisitions

Acquisition of Solicitors' Indemnity Fund Limited

On 1 October 2005 the Solicitors' Indemnity Fund Limited became a quasi subsidiary of the Law Society due to a change in Solicitors' Indemnity Fund rules.

In calculating the goodwill arising on acquisition, the fair value of net assets of Solicitors' Indemnity Fund Limited have been assessed and adjustments from book value have been made where necessary. These adjustments are summarised in the following table:

	Book value £'000	Revaluation of fixed assets £'000	Intra-entity balances £'000	Fair value £'000
Fixed assets:				
Tangible	4,054	6,336	-	10,390
Investments	163,531	-	-	163,531
Reinsurers' share of claims provision	38,907	-	-	38,907
Current assets:				
Debtors	7,883	-	-	7,883
Cash at bank and in hand	689	-	-	689
Total assets	215,064	6,336	-	221,400
Current liabilities:				
Creditors	(54,995)	-	25,000	(29,995)
Non current liabilities:				
Creditors	(25,118)	-	-	(25,118)
Gross claims provisions	(120,040)	-	-	(120,040)
Provision for other liabilities and charges	(5,657)	-	-	(5,657)
Net assets	9,254	6,336	25,000	40,590

	£'000
Cash consideration	-
Net assets acquired	40,590
Negative goodwill arising on acquisition (see note 8)	40,590

Notes to the accounts (continued)

23. Acquisitions (continued)

The revaluation of fixed assets relates to the assessed fair value of the freehold land and buildings on acquisition.

Intra-entity balances represent amounts owed by Solicitors' Indemnity Fund Limited to the Law Society at the date of acquisition.

The results of Solicitors' Indemnity Fund Limited prior to its acquisition are set out in note 11.

