INTERIM INDEPENDENT AUDIT COMMITTEE
28 MARCH 2013

SUBJECT	**REVIEW OF ACCOUNTING POLICIES**
REPORT BY	**CHIEF FINANCIAL OFFICER**
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SUMMARY AND PURPOSE OF REPORT

For the 2012/13 financial statements: to update the committee on the 2012/13 accounting policies.
Also, to describe the statutory environment for 2012/13 accounting and to propose the draft format of the statements.

RECOMMENDATIONS	***That:*** ***1. progress on the accounting policies attached at appendices 1-4 be noted;*** ***2. 'Approach A' from LAAP 95 should be adopted as the basis for accounting in this transitional year;*** ***3. the proposed accounting methodology for the 2012/13 accounts as described at section 5 be approved.***

A. SUPPORTING INFORMATION

1. Changes to policies

   1.1. An updated set of accounting policies are attached at Appendix 1. There are no significant changes from 2011/12, but the references now reflect the establishment of the PCC. They will be finalised when details of the IAS 19 actuarial assumptions are provided by Hymans Robertson in April.

   1.2. In their report on the 2011/12 accounts, the Audit Commission noted that the policy for component accounting was not fully compliant with the Code. An updated policy is shown at Appendix 2.

   1.3. The approach for recognising capital costs is described in Appendix 3. The materiality threshold is described in more detail below. Appendix 4 provides a summary of materiality and de minimis levels across the different accounting areas.

   1.4. Policies may be further amended subject to Local Authority Accounting Panel bulletins issued by CIPFA in the coming weeks. In particular, LAAP 96 is expected soon to advise on the 2012/13 closure of accounts.

2. Adoption of a materiality threshold for Lincolnshire Police Authority

2.1. Financial statements should present a true and fair view. An item that is not material will not be relevant, cannot influence a user's decisions and need not be reported in the financial statements.

2.2. Hence, ignoring immaterial items can save time and allows users of the accounts to focus on the main issues. However, materiality is subjective and requires professional judgement. It is inappropriate to set a fixed monetary value without reference to the context of a transaction. Factors which may make even small values material include:

- related party transactions;
- a transaction which changes a surplus to a deficit, or vice versa;
- non compliance with laws or regulations;
- deterioration in relationships with key stakeholders.

2.3. The guidance notes to the Code expect practitioners to presume that the Code should be followed until it can be established that a less rigorous approach does not lead users to misread the financial statements. There will be examples where no simplification is acceptable, some of which are listed above. However, in many cases a more straightforward approach will be considered the most pragmatic method. In such cases, the authority should have a default assessment of materiality for its financial statements.

2.4. It is proposed that the Authority adopts 0.1% of gross revenue expenditure as its own prudent materiality level, i.e., £100k. This will be used to inform internal considerations about the application of policies and accounting standards where doing so will not misrepresent the authority's position. Note that, as per the Code, it is the collective impact of a group of transactions which should be borne in mind rather than using this level to ignore transactions below £100k.

3. Legal and accounting framework for 2012/13

3.1. Two new bodies ("Corporation Soles"), the Police and Crime Commissioner for Lincolnshire and the Chief Constable for Lincolnshire, came into existence on 22nd November 2012 following the introduction of the Police Reform and Social Responsibility Act 2011.

3.2. The Financial Management Code of Practice for the Police Service of England & Wales (Jan 2012) clearly sets out that this change creates a 'Group' structure and the expectation that Group Accounts will be required (para 7.1).

3.3. The group and its individual entities continue to be bound by the requirements of existing legislation/regulations related to its accounting and audit obligations – i.e. the Local Government Act 2003, the Audit Commission Act 1998 and the Accounts and Audit (England) Regulations 2011. In essence this means that the accounts for the group will still need to be produced in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom ("the Code") and subject to audit.

3.4. The Chief Constable does not currently have Local Authority status which means that it does not have the legal right to reverse statutory accounting adjustments such as depreciation or actuarial pension adjustments. Whilst "intent" exists for the government to legislate for such a status, it is unlikely to be realised in time for the production of the unaudited accounts.

3.5. In December 2012, CIPFA issued Police LAAP Bulletin 95 which aimed to provide some clarity in terms of accounting requirements. Whilst it left many questions unanswered, the bulletin did present authorities with two distinct options (A & B) for presenting the changes and in producing the 2012/13 accounts.

3.6. Approach A requires that the establishment of the two police bodies are accounted for using merger accounting under FRS 6 Acquisition & Mergers. The justification for such an approach being that the change constitutes a group reorganisation, i.e. relative ownership remains the same in that the government retain the same degree of control both before and after the change. Accounts produced under this approach would assume that the new entities had always been in existence. A "normal" year's accounts would therefore be produced beginning on 1st April 2012 and showing comparatives for the entities (and consequently the Group) for 2011/12.

3.7. Approach B requires that the new entities be treated as beginning on 22nd November 2012. Thus accounts would be produced for a part-year up to November for the Police Authority, and from November to March for the PCC. This would bring complications over who could adopt the Police Authority accounts and whether they would be audited. Approach B may be suitable where there was significant structural change between the police authority and the PCC.

3.8. The national consensus has been an overwhelming support of Approach A on the grounds that it best reflects the reality of the situation, no change in overall control having taken place. It is therefore proposed to follow this approach and adapt as appropriate to local circumstances to ensure the accounts show a true and fair view of the activities of both entities and the group.

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4. Interpretation of the accounting framework

4.1. As the first to make the change to the new "group" structure, the Metropolitan Police (MOPAC and CPM) produced accounts for 2011/12 that have been scrutinised nationally due to them being the only available example of best practice.

4.2. Feedback from both CIPFA and Grant Thornton at recent accounting events suggests that the approach used by the Met is generally sound although must not be seen as a template for other Forces to follow. The main feedback points that need to be taken into account are:

- the accounting policies and methodology selected must be justified locally by reference to each group's Scheme of Arrangements;

- LAAP Bulletin 95 confirmed the requirement for prior year comparatives where merger accounting is to be used (Approach A);
- there may be implied operating leases between the PCC and Chief Constable for use of the PCC's assets which require disclosure;
- agreement should be sought and obtained from external auditors to the proposed methodology such that contention during the audit is avoided as far as is possible.

4.3. At a recent regional meeting, practitioners agreed that Approach A was to be taken and that differences in accounting approach would be due to local governance differences rather than a fundamental difference in interpretation of the accounting code and standards.

4.4. The Scheme of Arrangements sets out the overriding principle of the PCC having ownership of assets, setting the budgets and precepts, and allocating resources to the Chief Constable as required (see para 1.8 page 8) as well as being the contracting body that receives all income (para 1.9 page 9). Reserves cannot be used without PCC approval (section FR17, page 45) and so are clearly under the Commissioner's control.

4.5. However the Scheme of Arrangements also recognises that the Chief Constable has direction and control over the Force's officers and staff, and that he is accountable to the PCC for his use of resources (section HR9, page 22).

5. Proposed methodology for the 2012/13 accounts

5.1. The proposed methodology is based on the fact that the PCC owns both assets and liabilities, receives and controls all income and is the legal body that contracts with suppliers and employees. It also respects the fact that the Chief Constable will consume resources to deliver the aims of the Police and Crime Plan.

5.2. It is proposed that:

- Two sets of accounts will be produced – PCC/Group and Chief Constable
- The group accounts will be produced first and then disaggregated to form the individual entity accounts
- Accounting policies will be harmonised across the group and generally reflect the policies adopted by the former Lincolnshire Police Authority as described in Appendix 1
- The Police Pension Fund Account will appear as a supplementary statement to the Chief Constable's accounts but not within the PCC and Group accounts (a note within the group accounts will refer the reader to the Chief's accounts). Under the Police Reform & Social Responsibility Act 2011 the Chief Constable is the designated "Police Pensions Authority" for administration purposes
- All assets and liabilities will reside on the PCC/Group Balance Sheet only

- All banking and investments will be in the name of the PCC and hence on the PCC/Group Balance Sheet
- All income will be received by the PCC and shown in the PCC/Group Income & Expenditure Account
- The PCC's Income & Expenditure Account will show a transfer of resources to the Chief Constable's Operating Cost Statement equal to the cost of the resources consumed by the Chief Constable in delivering the Police and Crime Plan
- This transfer will be described as "the PCC's resources consumed, at the request of the Chief Constable, in delivering the aims of the Police and Crime Plan" (abbreviated as needed)
- Costs shown in the Chief Constable's Operating Cost Statement will be inclusive of statutory accounting charges such as depreciation or pension actuarial adjustments but will be reversed under Local Authority rules within the PCC/Group accounts
- The Force's share of the running costs of each section 23 Regional Collaboration (or "joint arrangement") will be included in the costs transferred to the Chief Constable
- The PCC's Income & Expenditure Account will show the costs of running the "Office of the Police & Crime Commissioner"
- All reserves will reside with the PCC/Group
- All cashflow movements will take place within the PCC/Group accounts reflecting the fact that the Chief Constable does not have his own banking arrangements
- Both sets of accounts will comply with "the Code" in that they shall include the four primary statements and supporting notes unless modified in agreement with External Audit
- Consideration will be given to the requirement for operating lease disclosures between the PCC and Chief Constable for the use of assets by the Chief
- A detailed review of the "Corporate & Democratic Core" disclosure in the accounts will take place to ensure that its elements are correctly split between the PCC and Chief Constable
- The Local Government Pension Scheme valuation will be carried out on a "single employer" basis in that the PCC will be the named employer and hence the pension liability will sit on the PCC/Group Balance Sheet. The effect of the IAS 19 adjustments will be included in the "cost of resources consumed" figures recharged to the Chief Constable's Operating Cost Statement. It is considered immaterial to request a separate valuation for relatively few police staff that are directly employed within the Office of the PCC
- The Police Pension Scheme valuation will be completed in the same way as the LGPS and accounted for in the same manner – the liability will sit with the PCC/Group
- IAS 19 adjustments will be split pro rata to the Office of the PCC for the purposes of Police Objective Analysis – i.e. in reporting the "Corporate & Democratic Core" figures in the Income & Expenditure Account

B. FINANCIAL CONSIDERATIONS

None.

C. LEGAL AND HUMAN RIGHTS CONSIDERATIONS

None.

D. PERSONNEL, EQUAL OPPORTUNITIES AND DIVERSITY ISSUES (including any impact or issues relating to Children and Young People.)

None.

E. REVIEW ARRANGEMENTS

The accounting policies will need to be updated before the publication of the draft accounts. Authority to do this should be delegated to the Chief Financial Officers.
Audit Committee will be made aware of any changes to policies and accounts format as the draft and final accounts are brought to the committee.

F. RISK MANAGEMENT

None.

G. PUBLIC ACCESS TO INFORMATION

Information in this report along with any supporting material is subject to the Freedom of Information Act 2000 and other legislation.