**JOINT INDEPENDENT AUDIT COMMITTEE**
**27 NOVEMBER 2014**

| SUBJECT | **REPORT TO THOSE CHARGED WITH GOVERNANCE – Review of accounting policies** |
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| REPORT BY | **JULIE FLINT, PCC CHIEF FINANCIAL OFFICER, AND TONY TOMLINSON, FORCE CHIEF FINANCIAL OFFICER** |
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| **SUMMARY AND PURPOSE OF REPORT**<br><br>To update the Committee on the 2014/15 accounting policies, describe the statutory environment for 2014/15 and propose the methodology for the preparation of the draft statements. | |
| **RECOMMENDATION** | That the Committee:<br><br>1. Review and note the accounting policies for 2014/15 attached at appendices 1 and 2.<br>2. Note the proposed accounting methodology for the 2014/15 accounts as described in section 5.<br>3. Note the assumptions and general approach used by Hymans Robertson for the LGPS and Police Pension Fund as described in section 6. |

## A. SUPPORTING INFORMATION

### 1. Introduction

Accounting policies are required for the accounts of the PCC group, the PCC and the Chief Constable. These policies describe the accounting practices used to produce the respective statements of accounts. They are included as the first note to the financial statements for the Group, the PCC and the Chief Constable accounts.

As the PCC Group accounts contain most of the transactions relating to assets and liabilities, many policies referred to below mainly relate to that set of accounts and are not applicable, and therefore excluded, from the Chief Constable accounts.

### 2. Changes to Policies

The proposed set of accounting policies for the PCC Group and Chief Constable are attached at Appendices 1 and 2 respectively. Last year the main changes affecting the PCC Group and the Chief Constable accounts related to adjustments to IAS19 disclosures and the PCC and Chief Constable accounts split. Policies may be further amended subject to Local Authority Accounting Panel bulletins issued by CIPFA in the remainder of the year, however currently there are no material changes to notes compared with 2013/14. The following policies have been highlighted for commentary:

**PCC and Chief Constable Accounts**

Since the finalisation of the 2013/14 yearend accounts there have been no further updates on the accounting approach for the PCC and Chief Constable. The proposed methodology for accounting for the PCC and Chief Constable entities is outlined in section 6 and the Committee will be notified of any future updates as they occur.

**IFRS 11 – Joint arrangements**

The PCC Group's regional collaboration work within the East Midlands currently falls under the category of a jointly controlled operation per accounting policy 1.35. There has been a change to the relevant accounting standard (IFRS 11) over the definition of such arrangements as either joint operations or joint ventures. The initial interpretation is that the change will not affect the Group's current approach; however this will be reviewed further in the year on receipt of revised guidance from CIPFA which incorporates the change in accounting standard. If there is no change we will continue to account for this as we have done previously which is on a line by line consolidation basis according to our percentage share of income, expenditure, assets and liabilities as apportioned in agreement with the region. If a change in policy is required it will be communicated at the next appropriate committee meeting.

**Component Accounting**

The Code requires that:

- Land and buildings should be accounted for separately;
- Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

Currently components are recognised for assets with a total value of over £500k, with the PCC's external valuer of assets providing high level estimates for breakdowns of component costs and lives. While this approach has been approved through the 13/14 audit process, a recommendation has been made that the PCC Group continue to move to a more comprehensive and detailed process for identification and costing of component assets. It is currently planned that this will take effect from the next full revaluation of land and buildings due for the 2016/17 accounts.

## 3. Materiality threshold for Lincolnshire PCC and Chief Constable

Financial statements should present a true and fair view. Items which are not material will not be relevant in informing a user's decisions and hence do not require disclosure in the financial statements.

The PCC and the Force maintains a number of de minimis thresholds for specific areas of its' financial accounting, outlined below.

| Policy Area | De minimis | Rationale |
|---|---|---|
| Yearend accruals | £5,000 | Budget holders can identify accruals to any level they wish but this de minimis allows them to focus on items that could materially affect individual budgets if they wish. |
| Inventory | £5,000 | The de minimis limits the time consuming |

| | | |
|---|---|---|
| | | counting of low volume stock which won't be material to the financial statements if charged to revenue. Most stock relates to diesel, vehicle parts and stores balances. |
| Capitalisation of Property, Plant and Equipment | £10,000 | Assets which meet the £10k de minimis level and also meet the other capitalisation criteria will be treated as capital. The PCC retains the discretion to consider capitalisation of other expenditure on a case by case basis, in particular where equipment with a life of more than a year is purchased in bulk as part of a specific programme. |
| Componentisation of Property, Plant and Equipment | £500,000 | Before the next full revaluation in 2016/17 components of property will only be recognised if they are considered to have a material impact on the fixed asset register. From the next full revaluation componentisation will be considered as part of the valuation process. |
| Contingent liabilities | £100,000 | This allows the Group to identify any potential liabilities that will likely be material to the future financial position. |

The external auditor will have its own materiality level for the purposes of its audit, to both direct its audit approach and when considering whether or not to report on audit adjustments identified. It is likely that the PCC and Force's materiality will be lower than audit's.

It is proposed that the PCC Group, the PCC and Chief Constable does not adopt a specific materiality figure in the preparation of its accounts but considers each area based on the nature of the transaction or disclosure in question. This will help inform internal considerations about the application of policies and accounting standards where doing so will not misrepresent the Group's position.

## 4. Interpretation of the accounting framework

There are currently no proposed changes to the PCC Group's interpretation of the accounting framework for 2014/15.

## 5. Proposed methodology for the 2014/15 accounts

**<u>PCC and Chief Constable split of transactions</u>**

The current methodology for the preparation of the 14/15 accounts continues the 2013/14 approach agreed with the Committee and the external auditor for splitting transactions between the PCC and Chief Constable. The PCC generally owns the assets and liabilities of the PCC Group, receives the majority of Government Grant income and in turn provides funding to the Chief Constable for it to deliver its operational obligations.

Additional or reviewed guidance may be provided closer to the financial yearend which requires re-evaluation of the current methodology. However until then it is proposed that no changes are made to the current approach that was agreed for the 13/14 accounts production.

**Review of accounting notes and disclosures**

Following the finalisation of the 2013/14 accounts a review is now underway of the PCC Group and Chief Constable accounts. This includes a benchmark exercise against a number of comparator PCC Groups to identify possible areas where the accounts can be streamlined for more efficient production and ease of understanding of the reader. This process will also include a full review against the updated 14/15 CIPFA Code of Practice and associated guidance.

**Schedule for production of draft accounts**

A draft timetable for the production of draft accounts:

1. XX May 2015 – Committee review draft accounts for PCC Group, PCC and Chief Constable
2. June 2015 – Publication of draft accounts for public inspection
3. July 2015 – Yearend audit of the financial statements
4. August 2015 – agreement of audit adjustments and revision of the accounts.
5. September 2015 – Committee review and approve final accounts

In order to facilitate the continuing earlier production of the yearend accounts and to address issues that occurred in 2013/14, a number of changes to the production of the accounts have been agreed for 2014/15:

1. February close down of accounts

Every month the financial ledger is reviewed prior to close down, with additional review at yearend as part of the opening stages of accounts production. A number of areas have been identified where this review can take place prior to the end of the financial year (with a subsequent summary check at the yearend) in order to bring forward the initial stages of accounts production, remove pressure on resources at yearend and contribute to the earlier production of the accounts going forward.

2. Regional accounting arrangements

The figures provided for Lincolnshire PCC's share of the regional operations are incorporated into the financial statements. The completion and production of these figures are outside of the PCC's control and as such can cause delays in the consolidation process for the accounts. To avoid delays and ensure a consistent approach in the production of the accounts for 2014/15, initial draft accounts will exclude the regional figures. This means that income and expenditure will exclude the regional transactions for the year and the Balance Sheet will roll forward all 13/14 balances without adjusting for 14/15 changes to assets, liabilities and reserves. The balances will then be consolidated once all figures have been submitted as final by the region. This will be in line with IFRS 11 noted in section 2. The net assets for the region in 13/14 were £1.1 million and as such are not considered sufficiently material to delay the production of the draft accounts for review.

3. Adjustments resulting from guidance changes

The late issuing of guidance relating to the PCC / Chief Constable split of accounts in 13/14 contributed to delays in the production of draft accounts and the subsequent review process. While there is little control over when guidance or update bulletins are issued, it is proposed for 14/15 that a cut-off date is agreed, around mid-April 2015, for when accounts production is agreed based on existing guidance only and further guidance is not considered until the audit process. This will allow production of the accounts to continue without delay and remove multiple versions of the accounts as guidance changes.

## 6. Assumptions used in the IAS19 pension disclosure

**Introduction**

IAS19 - Employee Benefits is one of the financial reporting standards that the PCC and Chief Constable must comply with when producing their Annual Accounts. IAS19's basic requirement is that an organisation should account for retirement benefits when it is committed to give them, irrespective of when they are paid out.

To calculate the cost of earned benefits for inclusion in the accounts, the scheme Actuary (Hymans Robertson) uses certain assumptions to reflect expected future events which may affect those costs. The assumptions used are designed to lead to the best estimate of the future cash flows that will arise under the scheme liabilities. Any assumptions that are affected by economic conditions should reflect market expectations at the balance sheet date.

The PCC Group's net Pension Liability as at 31 March 2014 was calculated at £1,107m. Given the material nature of the liability on the Group Balance Sheet it is important that the PCC group is supportive of the assumptions being made by the actuary in their calculations. This year's net position will be affected by the assumptions used, but does not immediately change ongoing revenue costs.

**Assumptions**

The calculated costs and the underlying assumptions, based upon the advice of the actuary and the administering authority (Lincolnshire County Council for the LGPS) will be used in preparing the PCC group's 2014/15 Accounts. The value of the Pension Funds' assets and liabilities are heavily dependent on the underpinning assumptions. The employer is ultimately responsible for the assumptions used.

The assumptions for 2014/15 have not been released for either the LGPS or the Police Pension, they will be released early in 2015 and provided to the Committee at the meeting subsequent to that. The principle assumptions used for the 2013/14 accounts are outlined below:

| | Local Government Pension Scheme | | Police Pension Scheme | |
|---|---|---|---|---|
| | 2012/13 | 2013/14 | 2012/13 | 2013/14 |
| **Long term expected rate of return on assets in the scheme:** | | | | |
| Equity investments | 4.5 | 4.3 | n/a | n/a |
| Bonds | 4.5 | 4.3 | n/a | n/a |
| Other | 4.5 | 4.3 | n/a | n/a |
| | | | | |
| **Mortality assumptions** | Longevity at 65 | | Longevity at 60 | |
| | Years | Years | Years | Years |
| Longevity for current pensioners: | | | | |
| Men | 21.2 | 22.2 | 21.2 | 29.3 |
| Women | 23.4 | 24.4 | 23.4 | 31.5 |
| Longevity for future pensioners: | | | | |
| Men | 23.7 | 24.5 | 23.7 | 30.9 |
| Women | 25.7 | 26.8 | 25.7 | 33.0 |
| **Financial assumptions** | % | % | % | % |
| Market derived RPI | 3.6 | 3.7 | 3.6 | 3.6 |
| Rate of increase in salaries | 5.1 | 4.1 | 3.8 | 3.8 |
| Rate of increase in pensions | 2.8 | 2.8 | 2.8 | 2.8 |
| Rate for discounting scheme liabilities | 4.5 | 4.3 | 4.5 | 4.3 |

Other demographic assumptions are used, e.g. rates of withdrawal from the scheme, number of ill-health early retirements, etc. These assumptions are based on past experience, and have not changed from those used in 2011/12.

There are no direct financial implications as a result of this report, as it sets out the input factors that the actuary uses to calculate the pension position for the PCC and the Chief Constable under IAS 19, showing the estimated net value of the group's portion of the pension fund (assets less liabilities). Changes in assumptions will affect the net position, but this has a nil overall change in the resources available to the PCC on the Balance Sheet, and any changes to the income and expenditure statement are reversed through statutory accounting entries.

If an employer wishes to use different financial assumptions the Actuary would impose additional fees.

## 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 be reviewed and updated before the publication of the draft 2014/15 accounts. It is recommended that this authority is delegated to the Chief Financial Officers of the Force and PCC. The committee will be made aware of any changes to policies as part of the review of draft and final accounts at future committee meetings.

## 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.