CIPFA The Chartered Institute of Public Finance & Accountancy

LAAP BULLETIN 98A

Closure of the 2013/14 Accounts in the Single Entity Financial Statements of Police and Crime Commissioner and Chief Constable

March 2014

The Local Authority Accounting Panel issues LAAP Bulletins to assist practitioners with the application of the requirements of the Code of Practice on Local Authority Accounting, SeRCOP and Prudential Code, and to provide advice on emerging or urgent accounting issues. Bulletins provide influential guidance that is intended to be best practice, but are not prescriptive and do not have the formal status of the Code, SeRCOP or Prudential Code.

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INTRODUCTION

1. The following Year End Local Authority Accounting Panel (LAAP) Bulletin covers the preparation of the single entity accounts of Police and Crime Commissioners and Chief Constables for the 2013/14 year. It follows on from LAAP 95 which dealt with the main accounting arrangements for the new bodies that were created under the Police Reform and Social Responsibility Act 2011. This bulletin should also be read in conjunction with the main LAAP Bulletin 98-*Closure of the 2013/14 Accounts and Related Matters* which provides additional general guidance and clarification to complement the 2013/14 Code Guidance Notes.

2. Since the previous guidance was issued in LAAP 95, the status of Chief Constables has changed under the Police Reform and Social Responsibility Act 2011 (Transitional Provision) Order 2013, which permits them to apply Sections 21 and 22 of the Local Government Act 2003 (accounts) to their transactions as they would apply in relation to a local authority. The explanatory note to the orders states that the"… *Order modifies Schedules 2 and 4 to the 2011 Act, with the effect that chief constables and the he Commissioner are treated as though they were subject to various local government enactments concerning accounting practices, and particularly the charging of expenditure to a revenue account. The purpose is to ensure that staff pension liabilities are treated in accordance with accepted practices in the accounts of chief constables and the Commissioner*."

3. The Bulletin has been produced in response to requests from police bodies for additional clarification guidance to assist with the accounting arrangements in the single entity financial statements of the Police and Crime Commissioners and Chief Constables.

BACKGROUND

4. The Police Reform and Social Responsibility Act 2011 not only provided for the introduction of the two corporations sole but also provided flexibility to police bodies to put in place local arrangements as to how responsibilities and delegations would be managed between the Police and Crime Commissioner and the Chief Constable in their local areas. Consequently, it was anticipated that this might lead to significant variations in the accounts of the individual bodies due to the need to reflect their local arrangements.

5. To assist police bodies in England and Wales with their accounting arrangements under the new provisions, LAAP Bulletin 95, the provisions of which remain extant, was issued in December 2012. The Bulletin not only dealt with the transfer of functions from the abolished Police Authority to the Police and Crime Commissioner but also provided useful guidance to assist police bodies with the individual accounting arrangements in their single entity financial statements (see paragraph 9 below). LAAP Bulletin 95 also provides details of the statutory background regarding Police and Crime Commissioner and the Chief Constable. The Bulletin can be found at:

   Download LAAP Bulletin 95

6. In March 2013 CIPFA's Police Panel provided further assistance in a briefing note for practitioners in response to their questions on the recognition of assets and employees in the Police and Crime Commissioner and Chief Constables' accounts. This briefing note was intended to help practitioners in applying the requirements of LAAP Bulletin 95. In addition, a checklist was included in the briefing note to assist in this process. However, it is important to note that the checklist was intended only as an aide to assist finance staff in assessing whether assets and employees should be reflected in the accounts of the Police and Crime Commissioner or the Chief Constable. **The checklist was not meant to override the prime tests in the Code eg under IASs 16 Property, Plant and Equipment and 17 Leases[1], and Service Concession Arrangements (PFI)**, but merely to assist with practitioners' decision making for the recognition of assets and staff costs between the separate entities. As stated in the briefing note, in the case of any conflict or contradiction, LAAP Bulletin 95 was the authoritative source of guidance[2].

7. Police bodies have however asked CIPFA to provide additional clarification guidance. This bulletin will assist them to make informed decisions about their accounting arrangements and in particular they would like the Local Authority Accounting Panel (LAAP) to provide them with clarification guidance regarding Principal and Agent arrangements as required by the Code to assist with these decisions.

8. In response to this and to further assist police bodies, LAAP has agreed to:

- augment and reiterate the guidance it provided in LAAP 95 regarding the single entity financial statements of Police and Crime Commissioners and the Chief Constables (see paragraphs 9 and 10 below)
- set out the Code's requirements for Principal and Agent arrangements together with the detailed guidance (consistent with that in the Code Guidance Notes) covering this area (see paragraphs 11 to 17 below)
- provide guidance on Substance over Form (consistent with that in the Code and the Code Guidance Notes) (see paragraphs 18 to 23 below), and
- provide practical guidance to assist with analysing transactions in relation to staff costs and property, plant and equipment in the respective accounts of either the PCC and CC (see paragraphs 24 to 31 below)

LAAP BULLETIN 95

9. LAAP 95 made a number of recommendations that the Police and Crime Commissioners were advised to consider in relation to the accounting arrangements in their single entity financial statements (and similarly those of the Chief Constable). These recommendations are set out in following paragraphs a) to d) and included below for ease of reference:

1 This may include the Code's provisions on other lease type arrangements.
2 In addition it may be necessary to refer directly to the provisions of the Code of Practice on Local Authority Accounting in the United Kingdom or to legislative requirements.

a) The relationship of the Police and Crime Commissioner and the Chief Constable means that both entities need to consider very carefully the income and expenditure, assets, liabilities and reserves that they recognise in their single entity financial statements. The Police and Crime Commissioner needs to follow the relevant section of the Code in relation to the recognition of these items in the financial statements and consider in depth any formal or informal arrangements for the allocation of resources between themselves and the Chief Constable.

b) As with all accounting transactions, Police and Crime Commissioners (and Chief Constables) need to consider the **substance of transactions in determining whether to recognise income, expenditure, assets, liabilities and reserves and not solely their legal form**. So, whilst for instance the legal arrangements might mean that the Police and Crime Commissioner legally owns the land (eg, police stations), it needs to be satisfied that it is able to recognise the asset through control of future economic benefits or service potential that are expected to flow from it as a result of past events[3]. See paragraphs 18 to 23 below for further discussion on the concept of Substance over Form.

c) In relation to expenditure, the recognition of employee costs (including pension costs and liabilities) requires careful consideration. Again, Police and Crime Commissioners (and Chief Constables) need to ascertain which staff is under their control and where the expenditure is recognised in the financial statements. If, for example, categories of staff are employed by the Police and Crime Commissioner, it needs to assess whether it controls the outflow of this resource, before recognising the employee costs in the financial statements. This requires a careful evaluation of the events, circumstances and transactions relating to the relevant employees and may not be the same for all categories of staff. The same employee costs cannot be recognised as employee expenditure in the financial statements of both the Police and Crime Commissioner and the Chief Constable.

d) Police and Crime Commissioners and the Chief Constables should establish the incidence of employee expenditure for each of their financial statements as this influences the identification of the pensions obligations that each is obliged to meet.

10. Practitioners should note that the above guidance, which was relevant to the accounting arrangements when the new structure was established at 'stage one', is equally as relevant to the decisions that Police and Crime Commissioners to Chief Constables will take at 'stage two', when greater responsibility for assets and employees may be transferred by Police and Crime Commissioners to Chief Constables.

AGENT AND PRINCIPAL RELATIONSHIP

Features of Agent and Principal Relationships

3 See paragraph 4.1.2.16 of the 2013/14 Code

11. Paragraph 2.6.1.1 of the 2013/14 Code requires that:

'*The accounting treatment of transactions within an authority's financial statements shall have regard to the general principle of whether the authority is acting as the principal or agent, in line with IAS 18 Revenue, IPSAS 9 Revenue from Exchange Transactions and IPSAS 23 Revenue from Non-Exchange Transactions (Taxes and Transfers)*'.

12. The Code stipulates that an authority **is acting as an agent** in situations or circumstances 'where the authority is acting as an intermediary'. It **is acting as a principal** in situations or circumstances 'where the authority is acting on its own behalf' (paragraphs 2.6.2.1 and 2.6.2.2 of the Code). Therefore, the main decision for both bodies is whether they are acting on their own behalf or on behalf of the other body.

13. It is acknowledged in the Code Guidance Notes that the above mentioned standards provide limited assistance to identify when a police body acts as a principal or an agent or for the accounting for such principal and agent activities. However, additional guidance was added to the appendix to IAS 18 in 2009[4] regarding the determination as to whether an entity is acting as **a principal or an agent**.

14. It may be useful to look at some of the new principles established in IFRS 10 *Consolidated Financial Statements*[5] to analyse these risks and rewards (though it is recognised that the agent principal relationship is considered in IFRS 10 as regards the relationship of a decision maker investor with an investee). Although the following paragraphs are using the principles in IFRS 10 to arrange the factors that police bodies are likely to need to consider, this bulletin is not, however, relying on the provisions of the standard.

15. The issues that IFRS 10 looks at that are relevant to the police bodies include:

- the scope of its decision-making authority; and
- the rights held by parties.

16. **The scope of the decision making authority** – when considering whether the PCC or CC is principal for the transactions what needs to be considered is:

- the purpose and design of each body and the resultant risks to which each body will be exposed; and
- the risks that the statutory structure of the two bodies was intended to pass on to the PCC or the CC.

These might include employment risks, operational risks and financial risks (for individual elements of the police budget).

17. **The rights held by the parties** – IFRS 10 focusses on the ability of removal rights in the relationship with the investee. This may be a relevant consideration for the relationship with the PCC. The CC is appointed by the PCC

4 Effective date of 1 January 2010
5 IFRS 10 will be adopted in the 2014/15 Code

who may also dismiss the CC. However, this does not demonstrate the full relationship between both bodies whilst the PCC may be able to dismiss the person of the CC, it cannot dissolve the office of the CC as statutory body has been created by statutory provisions.

SUBSTANCE OVER FORM

18. Substance over form is fundamental to the recognition and measurement of transactions in the financial statements and requires the use of judgment by management in order that the accounts reflect the economic reality of the entity's transactions and arrangements.

19. Representing a legal form that differs from the economic substance of the underlying transactions or events will not result in a faithful representation of the financial statements[6].

20. For example, it is usually straightforward to ascertain whether or not an entity holds legal title on an item of property. However, in accounting terms the legal form is less important than the economic reality/substance of the transaction and the recognition of the asset would be governed by the indications that the entity controls the future economic benefits or service potential inherent in the property[7] (see 9 b) above).

21. Management should be alert to situations where substance should take precedence over form – eg where the legal form of a transaction differs from the authority's stated objectives for the enterprise or what might occur in practice.

22. Management should therefore consider all the transactions and implications relating to an item, event, or other condition, before making decisions about recognition and measurement.

23. The above discussion is based on the guidance on Faithful Representation and Substance over Form in Module 2, paragraphs A55-A59 of the 2013/14 Code Guidance Notes.

ANALYSING TRANSACTIONS BETWEEN THE POLICE AND CRIME COMMISSIONER AND THE CHIEF CONSTABLE

Clarifying Roles and Responsibilities

24. Both the Office of the Police and Crime Commissioner and the Office of the Chief Constable are corporation soles with specific duties laid out within statute. The key rights and statutory responsibilities held by both offices are:

Police and Crime Commissioner

6 Paragraph BC3.26 of the IASB Conceptual Framework.
7 Paragraph 2.1.2.23 of the 2013/14 Code defines an asset as – a resource controlled by the authority as a result of past events and from which future economic benefits or service potential are expected flow to the authority

- statutory duty and electoral mandate -to ensure an efficient and effective police service and to hold the police (including the CC) to account on behalf of the public;
- setting and updating the four year police and crime plan (in consultation with the CC);
- setting the force budget and council tax contribution to policing (precept).

Chief Constable

- the CC is responsible for maintaining the Queen's Peace, and has direction and control over the force's officers and staff;
- the CC is accountable in law for the exercise of the police powers and to the PCC for the delivery of effective policing, management of resources and expenditure.

25. The existence of distinct responsibilities under statute relating individually to the Police and Crime Commissioner and Chief Constable that cannot be delegated mean that a single overarching principle and agent relationship between the Police and Crime Commissioner and the Chief Constable cannot exist.

26. The Police and Crime Commissioner has the power to dismiss the postholder of the Office of the Chief Constable but cannot remove the office itself or provide core policing through any other means than the Office of the Chief Constable given their legal responsibilities for maintaining the Queen's Peace.

27. The Police and Crime Commissioner and Chief Constable will need to clarify the roles and responsibilities of their office in relation to their income, expenditure, assets, liabilities and reserves.

Example illustration

Where police bodies conclude for their circumstances that even though some of the financial risks relating to Police Officers are with the PCC, the CC would need to reflect the entire costs of the officers over which the Chief Constable has operational direction and control.

The position might be more complex for police (civilian) staff who support the work of the Chief Constable but who are employed by the PCC. In this case the PCC may need to recognise their costs in the accounts of the PCC.

Other staff may provide services to both bodies. In such cases, these costs would need to be apportioned on a reasonable basis between the two bodies.

There are specific costs that can only relate to the office of the Chief Constable and the Office of the Police and Crime Commissioner, for example:

- The employee costs of the Chief Constable and the Police and Crime Commissioner
- Their individual audit fees
- Statutory posts assigned to the individual offices, for example the Chief Financial Officer.

The Police and Crime Commissioner and Chief Constable will need to determine

the substance of arrangements for the making of assets available to the Chief Constable including consideration of such factors as the extent to which the PCC has retained formal control over the assets and the ability of the Chief Constable to continue to use the asset for its useful life.

Disclosure of Judgements Made by Management

28. Where the decisions being made have a material impact on the financial statements, the PCC and CC should disclose this as a judgement that management has made in the process of applying its accounting policies as required by the Code's adoption of IAS 1 (see paragraph 3.4.2.81 of the Code). This requires that the judgements (apart from those involving estimations) that management have made in applying their authority's accounting policies should be disclosed in the summary of significant accounting policies or otherwise in a note to the accounts. The relevant judgements are those that have the most significant effect on amounts recognised in the financial statements.

29. These stipulations have the effect of requiring authorities to justify the view they have taken on significant transactions and balances to provide an appropriate explanation of the factors that were taken into account and any assumptions made when making the judgement, together with the outcome.

Presentation of the Financial Statements

30. The presentation of the financial statements will need to follow the prescriptions of section 3.4 of the Code. This includes the prescriptions for the list of the complete set of financial statements per paragraph 3.4.2.17 of the Code for both the single entity and group accounts.

31. Where the presentation of police bodies' accounts has changed between years they will need to consider section 3.3 of the 2013/14 Code- *Accounting Policies, Changes in Accounting Estimates and Errors.* Further guidance is provided in Module 3, section D of the 2013/14 Code Guidance Notes.

STAGE 2 TRANSFERS

32. The Police Reform and Social Responsibility Act 2011 provides for a 'Stage 2 transfer' where Police and Crime Commissioners can agree what assets, police staff, rights and liabilities are transferred from them to the Chief Constable.

33. Subject to approval by the Home Secretary, the Stage 2 transfers must be in place on 1st April 2014 and will apply from the 2014/15 year.

34. Police bodies are reminded that the guidance provided above, which was relevant to the accounting arrangements at 'stage one', is generally equally as relevant to the decisions that Police and Crime Commissioners to Chief Constables will take at 'stage two', when greater responsibility for assets and employees may be transferred by Police and Crime Commissioners to Chief Constables. It might be the case that police bodies' preparations for the stage 2

process might provide more evidence for the substance of the transaction at stage 1.

35. Where transfers take place on 1April 2014, LAAP would anticipate that the 2013/14 financial statements should report a non-adjusting event after the reporting period for transfers.