Audit Policy Briefing 04-2014

Guidance on the audit of the single entity accounts of the office of the Chief Constable and the office of the Police and Crime Commissioner for 2013/14

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This APB is relevant to auditors of police bodies:

- the office of the Chief Constable (CC); and
- the office of the Police and Crime Commissioner (PCC).

Background

The purpose of this APB is to give auditors authoritative guidance in support of audits of the 2013/14 accounts of police bodies.

Standing Guidance, which forms parts of the terms of appointment, requires auditors to have regard to guidance issued by the Commission.

The Police Reform and Social Responsibility Act 2011(the Act) created two corporations sole, the PCC and the CC, in each local police area in England and Wales[1]. The Act encouraged the development of local arrangements in each area.

In 2012/13, the first year that PCCs and CCs (outside London) prepared accounts as corporations sole, there was a major inconsistency in the accounting approach adopted in different local areas, with some CCs recognising no income and expenditure, and others recognising the costs of policing and some assets and liabilities.

This inconsistency led to significant discussions between stakeholders in the police sector and was commented on in the National Audit Office's Police accountability: Landscape review report.

The Commission has agreed with auditors that the guidance in this APB should support greater consistency between auditors in carrying out their audits of the accounts of PCCs and CCs.

In March 2014, CIPFA issued Local Authority Accounting Panel (LAAP) Bulletin 98A: Closure of the 2013/14 Accounts in the Single Entity Financial Statements of Police and Crime Commissioner and Chief Constable to assist police bodies in applying the Code of Practice on Local Authority Accounting (the Code), and to promote consistency in the application of requirements.

The guidance to auditors in this APB sets out the Commission's view on the reasonable interpretation of the application of LAAP Bulletin 98A to police body accounts.

[1] Except for the City of London, where the Corporation of the City of London remains the police authority for the City of London Police.

Section 1: Information and guidance available and relevant to the 2013/14 accounts

Since the preparation, audit and publication of the 2012/13 accounts of police bodies, there have been significant developments which impact on the preparation of 2013/14 accounts. The following changes provide relevant information in respect of police body accounts which the preparers and auditors of the accounts should consider when deciding on their approach for 2013/14.

Statutory changes

Legislative changes[2] have now applied part of the Local Government Act 2003, including sections 21 (accounting practices) and 22 (revenue account), to CCs as well as PCCs. This means that Sections 21 and 22 of the Local Government Act 2003 apply to relevant transactions of the CC as they would in relation to a local authority. In particular, this change confirms that the Code is applicable to the accounts of CCs. It also means that the CCs' accounts are now within the remit of LAAP and so LAAP Bulletin 98 applies to both PCCs and CCs.

Stage 2 transfers

These took effect from 1 April 2014 in 40 of the 42 local police areas affected by the Act. While not applying directly to 2013/14, they may provide further evidence relevant to auditors' consideration of the respective roles of PCCs and CCs when reaching a view on the substance of transactions between PCCs and CCs and how these should be accounted for. In particular, they may provide evidence about the substance of arrangements that were being developed and implemented in 2013/14.

LAAP Bulletin 98A confirms that practitioners should consider the implications of the Stage 2 transfers on the substance of transactions.

LAAP Bulletin 98A

LAAP Bulletin 98A was published in March 2014 as guidance to preparers on the application of the relevant accounting framework. It specifically addresses issues identified during the 2012/13 accounts preparation and audit process.

[2] The Police Reform and Social Responsibility Act 2011 (Transitional Provision) Order 2013 applies these sections to CCs from 1 April 2013 and will be replaced by Section 141 of the Anti-social Behaviour, Crime and Policing Act 2014 when it comes into force from 13 May 2014

LAAP is the relevant source for guidance on the interpretation and application of the Code and LAAP Bulletin 98A provides guidance to police practitioners which should be followed unless there are reasonable grounds for not doing so. The Commission's view on the reasonable interpretation of the LAAP bulletin is:

LAAP bulletin	**Reasonable interpretation**
The applicability of agent and principal under the Code (IAS 18) to police accounting (paragraphs 11-17 and 25)	CIPFA's clear interpretation of the Code on whether under IAS 18 principal/agent can be applied is: *a single overarching principal and agent relationship between the Police and Crime Commissioner and the Chief Constable cannot exist (paragraph 25)*. The CC is solely responsible, as principal, for those statutory functions that only the CC can carry out. In particular, the CC is solely responsible, as principal, for directing operational policing and so the relevant costs of operational policing need be recognised in the CC's accounts. As a minimum, the costs of warranted police officers and certain other costs of the office of the CC need to be recognised in the CC's single entity accounts.
Substance over form (paragraphs 18-23)	Police bodies should consider the underlying substance of the transactions rather than just the legal form. This is particularly relevant as legal title is held by the PCC at Stage One. The bulletin states: *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 (paragraph 21).*
Analysing transactions between the PCC and the CC (paragraphs 24-27)	As a result of the requirements to consider the underlying substance of the arrangements (set out above) this section makes clear how this applies to the statutory responsibilities of the PCC and the CC and their respective powers – the PCC in regard to strategic policing and the CC with regard to operational policing.

LAAP bulletin	Reasonable interpretation
	This section gives an illustrative example applying paragraphs 18 to 27 to the accounts of police bodies (including making it clear that the costs of operational policing should be reflected in the accounts of the CC).
The relevance of Stage 2 transfers to 2013/14	This considers that Stage 2 should be considered in so far as it may give further evidence of the underlying substance of the transactions at Stage 1.

The Commission has set out detailed guidance on our interpretation of LAAP Bulletin 98A in the rest of this APB.

Section 2: Clarification on whether the Chief Constable acts solely as an agent of the Police and Crime Commissioner

What is the issue?

The main area of inconsistency in the basis on which police bodies prepared their financial statements in 2012/13 was whether the CC was judged to be acting solely as an agent of the PCC. Police bodies who argued that the CC was acting as an agent and therefore should not recognise any income or expenditure in their Comprehensive Income and Expenditure (CIES) Account did so under the Code, applying a principal/agent argument under IAS 18: *Revenue*. This argument concluded that based on local arrangements the CC was acting solely as an agent of the PCC and that all resources consumed were on behalf of the PCC.

This argument was made in the absence of any guidance issued by CIPFA in 2012/13 as to whether it was appropriate to interpret the Code in this way. CIPFA has now issued guidance in LAAP Bulletin 98A on how the Code should be interpreted in respect of whether under IAS 18 the CC can be acting solely as an agent of the PCC.

The Code, which is applicable to CCs as well as PCCs in 2013/14, 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, CIPFA has considered whether, under the Code (and the underlying standard: IAS 18), there is sufficient evidence to determine if the CC is acting on its own behalf or on behalf of the PCC.

While the PCC is empowered to appoint and remove the CC, the PCC has no power to take on the statutory functions of the office of the CC (the corporation sole for whom the accounts are prepared) or to appoint another body to carry out the statutory functions of the office of the CC. Therefore, CIPFA has concluded that both entities can only be operating in their own right (i.e. that the interpretation under the Code is that they are both acting as principal in relation to their statutory functions). This is clearly stated in paragraph 25 of LAAP Bulletin 98A:

> *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 principal and agent relationship between the Police and Crime Commissioner and the Chief Constable cannot exist.*

The Commission agrees with CIPFA that the CC is solely responsible, as principal, for those statutory functions that only the CC can carry out. Therefore, there is no basis for police bodies under the Code to conclude that the CC is acting solely as the agent of the PCC. In our view, bodies who adopted this accounting policy last year will therefore need to change it to reflect this change to the recognition of income and expenditure in the 2013/14 financial statements.

Paragraph 31 of LAAP Bulletin 98A reminds practitioners that:

> *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.*

What should auditors do?

It is the Commission's view where police bodies in 2012/13 had an accounting policy under IAS 18 that the CC was acting solely as the agent of the PCC they will need to adopt a change in accounting policy for 2013/14. The availability in 2013/14 of more reliable and relevant information on the body's financial position or financial performance (particularly the interpretation of the Code on the applicability of IAS 18 provided by LAAP Bulletin 98A) means that this change in accounting policy will require a prior period adjustment.

If bodies disregard the interpretation of the Code on the applicability of IAS 18 set out by CIPFA for their 2013/14 accounts and do not make a prior period adjustment for 2012/13, auditors will need to consider whether to qualify their audit opinion. This is because auditors are required to conduct their audit in according with auditing standards, including ISA (UK and Ireland) 705: *Modifications to the opinion in the independent auditor's report*. Failure to recognise the relevant costs of discharging the CC's statutory responsibility for directing and controlling operational policing in the CC's accounts means that the policies are unlikely to be consistent with the framework (paragraphs 24(b) and A4(a)), i.e. the interpretation of the Code as set out in LAAP Bulletin 98A and do not achieve a fair presentation (paragraphs 24(a) and A4(b)), i.e. are not reflecting the underlying substance of the statutory powers of the CC.

The effect of this failure on the financial statements is likely to be material and pervasive (as defined in paragraph 5). IAS 705 therefore requires auditors to consider whether to issue an adverse opinion (paragraphs 8 and A1).

Where a police body proposes to follow an approach that is inconsistent with the LAAP Bulletin 98A, the auditor should consult the Commission via ACTS.

Section 3: What items should the PCC and the CC account for?

What is the issue?

CIPFA confirms in LAAP Bulletin 98A the Code requirement that in preparing and auditing police body accounts, practitioners and auditors should consider the substance of the underlying statutory requirements and responsibilities of the CC (operational policing) and the PCC (strategy and oversight). Individual items of account should therefore be recognised under the relevant accounting standard (IAS 19 for employee costs and IAS 16 for PPE) and included in the financial statements of the body which reflects the substance of their use.

Presentation of the accounts of the PCC and CC

LAAP bulletin 98A, paragraph 30, reminds bodies of the Code requirement that:

> *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.*

Both the PCC and CC need to prepare financial statements that comply with the Code requirements including a CIES, balance sheet and cashflow statement.

Recognition of Income and expenditure items in the CIES

Paragraphs 24-27 of LAAP Bulletin 98A set out the underlying substance of the statutory roles of both the PCC and CC. CIPFA is clear in the illustrative example that given these separate legal responsibilities there are specific items of income and expenditure related to each corporation sole that will need to be recognised in the PCC's and CC's CIES, i.e. there cannot be a situation where the CIES of the CC or the PCC have nothing but zero entries.

LAAP Bulletin 98A states:

> *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.*

This list is not meant to be exhaustive. Expenditure should be recognised in line with how it is incurred as a result of the statutory duties and responsibilities of each of the offices. Auditors will therefore consider whether the CIES of each body contains the relevant income and expenditure items in accordance with the requirements of the relevant accounting standards, of which the most significant is, IAS 19: *Employee Benefits* for the costs of the statutory employment positions.

Employee costs

In recognising the costs of policing, bodies, under the Code, will need to consider the requirements of IAS 19. This does not use control of risks and rewards in determining recognition but rather considers which body is responsible for incurring employee expenditure, and requires that body to account for it appropriately. LAAP Bulletin 98A reminds practitioners in making this judgement that the underlying substance of who the employment is incurred for should be considered and not just the legal form.

Warranted police officers

Warranted police officers are employees of the Crown and represent the most significant element of operational policing which the CC is solely responsible for controlling and directing as principal. Paragraph 26 of LAAP Bulletin 98A concludes that it is the office of the CC which has the legal responsibility for maintaining the Queen's Peace (on behalf of the Crown), and so has direction and control over the force's warranted officers. It is therefore the Commission's view that the only reasonable interpretation is as set out in the illustrated example, that:

> *… even though some of the financial risks related 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 [in the accounts of the office of the CC].*

In other words, given the specific statutory responsibility on the office of the CC with regards to operational policing, CIPFA is clear, and the Commission agrees, that the full IAS 19 costs of warranted police officers should be reflected in the CC's financial statements. This would include salary costs in the CIES and accumulated leave balances, tax and social security creditors and pension liabilities on balance sheet.

Civilian staff

CIPFA acknowledges that judgement need to be exercised for civilian staff who do not hold the office of constable. LAAP Bulletin 98A states:

> *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* (emphasis added).

Section 2(3) of the Act states:

> *A police force, and the civilian staff of the police force, are under the direction and control of the chief constable of the force.*

This is strong evidence therefore that under the statutory power of the CC the substance of the arrangement is that some civilian staff, for example PCSOs and SOCOs, support the work of the CC and that their role brings them under the operational control and direction of the CC. It is likely therefore that they should be accounted for in the CC's financial statements, but the substance of local circumstances will need to be considered by each police body.

Bodies will need to provide evidence supporting their accounting for non-warranted staff. The Commission's view is that the allocation of staff should reflect the respective statutory roles of the PCC and CC. Auditors will therefore wish to consider how the body has demonstrated:

- whether the main role of the staff member supports the strategic role of the PCC or the operational policing role of the CC (for example control room staff would be more likely to be accounted for in the CC's financial statements whereas a policy officer would be more likely to be accounted for in the PCC's); and
- the underlying substance of the employment relationship, clarified further by Stage 2 transfers which may see employment contracts of certain non-uniformed staff transferred to the CC.

Bodies will wish to consider how they present the IAS 19 related costs of staff in the respective accounts of the PCC and CC, particularly for civilian staff that may be in the local government pension scheme (rather than the police pension scheme). Bodies will need to consider how these liabilities are reflected in the separate financial statements of the PCC and CC. The auditor will wish to consider the material accuracy of any such presentation including any work the body has commissioned from its actuary.

Recognition of items on the Balance Sheet

Working capital

CIPFA does not give any specific suggestions for how working capital should be treated in the accounts of the PCC and CC other than with regard to IAS 19 liabilities for staff under the direction of control of the CC and PCC (see above).

It is likely given the role of the PCC that they will account for the majority of these transactions as any assets or liabilities between the PCC and CC will be settled virtually as soon as they arise. However, auditors will wish to consider, given the accruals basis of accounting, how any items in the CIES need to be reflected in the balance sheet. There also may be local arrangements in operation, for example, the CC has the power to enter into contracts (with the consent of the PCC) and therefore incur relevant working capital items.

Property, Plant and Equipment (PPE)

CIPFA makes clear that the Code applies and therefore PPE should be accounted for in accordance with IAS 16: *Property, Plant and Equipment*. IAS 17: *Leases* would only be appropriate to consider if there is some form of charge being made by one party to the other for the use of specified assets. In the absence of any such charge the bodies will need to consider the recognition requirements of IAS 16 to evidence their judgement as to which body recognises which assets.

LAAP Bulletin 98A gives guidance on this approach:

> *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.*

CIPFA, although not specifying which assets a body should retain, does give an approach that bodies can follow in assessing which assets are shown in which set of financial statements. In essence this is considering them in a matrix based on:

- how closely the consumption of the asset relates to either delivering the operational policing responsibility of the CC or the strategic responsibility of the PCC; and
- the length of the asset life and how much of its useful economic life will be consumed on the particular activity it is currently being consumed for.

In practice this may mean that assets such as radios, police vehicles, other police specialised equipment (such as IT) may be more likely to be recognised in the accounts of the CC. Assets such as buildings and more general IT systems are more likely to be recognised in the accounts of the PCC. Auditors will wish to consider the reasonableness of arguments set out by the PCC and the CC as to the balance of risks and rewards under local arrangements and the materiality of the assets in question, as to how assets are recognised in their financial statements.

Where the CC uses an asset made available by the PCC, but does not recognise the asset on its balance sheet, the PCC will need to consider whether to charge the CC for using the asset. Where a PCC does this the charge should reflect the fair value for making the assets available for use and these charges to be shown in the financial statements.

If a charge is not made, the auditor will wish to consider whether the PCC is effectively providing the CC with goods in-kind as a non-exchange transaction. If the auditor concludes this is the case they will wish to consider:

- paragraph 2.3.2.19 of the Code which refers bodies to IPSAS 23: *Revenue from Non-exchange Transactions*; and
- paragraph 96 of IPSAS 23 effectively requires the entity receiving the goods in-kind to recognise the fair value of the good in-kind as income: *'goods in-kind are recognized as assets when the goods are received, or there is a binding arrangement to receive the goods. If goods in-kind are received without conditions attached, revenue is recognized immediately. If conditions are attached, a liability is recognized, which is reduced and revenue recognized as the conditions are satisfied'*.

Presentation of the Cash Flow Statement

The Code requires that both the PCC and CC produce a cash flow statement.

Consideration will be needed by the CC as to how they present their cash flow statement to reconcile this with the other primary statements. While the CC may not have a bank account or physically hold cash, it can still show a reconciliation and tailor the notes to reflect these particular circumstances. Auditors will wish to consider that the cashflow statement is prepared and disclosed appropriately.

Management judgements

Both the PCC and CC in preparing their financial statements will need to exercise judgement. Paragraphs 28 and 29 of LAAP Bulletin 98A remind preparers of relevant Code requirements by stating that:

> *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*[: Presentation of Financial Statements] *(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.*
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> *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.*

Auditors will therefore wish to satisfy themselves that management judgements have been appropriately disclosed with the respective financial statements of the PCC and CC.

Reflecting changes from 2012/13

The 2012/13 accounts for some CCs reflected income, expenditure, assets and liabilities. Some of the items of account recognised may no longer be appropriate to include in the 2013/14 accounts given the guidance now available to police bodies and their auditors.

Auditors will wish to consider whether they agree with the body as to whether these changes:

- require a prior period adjustment as a result of a change to accounting policies or to correct material errors. Changes in accounting policies should be made when the change provides more reliable or relevant information about the effect of transactions, other events and conditions on the body's financial position or financial performance. Where a change is made, it is applied retrospectively (unless stated otherwise) by adjusting opening balances and comparative amounts for the prior period as if the new policy had always been applied; or
- reflect a change in estimation technique(s) and therefore need only to be accounted for prospectively.

What should auditors do?

Auditors should give careful consideration to the issues raised above and discuss this guidance with their police bodies. Where a CC has not recognised their own specific costs and at least the full IAS 19 expenditure and liabilities relating to warranted police officers, in both 2013/14 and the prior period comparative, auditors will need to consider the implications for their audit reporting and may consider issuing an adverse audit opinion on the grounds set out in section 2 of this APB.

Auditors should consult the Commission via ACTS if any police bodies do not intend to follow the guidance given in LAAP Bulletin 98A.

Process for raising technical issues

Auditors in firms should raise queries within the firm, in the first instance, so the relevant technical support service can consider whether to refer queries to ACTS by e-mailing ACTS@audit-commission.gsi.gov.uk

The Commission also has a local government Technical Leads Network which will meet virtually to consider and resolve any emerging regime-wide technical issues on a timely basis. Auditors should follow their in-house arrangements for bringing significant emerging issues to the attention of their supplier's representative.