

POLICE LAAP BULLETIN 95

Accounting for the Impact of Police Reform - the Accounting Arrangements for the Transfer of Functions to the Police and Crime Commissioner (England and Wales)

December 2012

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 in the United Kingdom (the Code), the Service Reporting Code of Practice (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 the Prudential Code.

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technical.enquiry@cipfa.org

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ACCOUNTING FOR POLICE REFORM 2012/13

INTRODUCTION

1. The following Local Authority Accounting Panel (LAAP) Bulletin covers the main accounting arrangements for the new bodies that have been created under the Police Reform and Social Responsibility Act 2011. The Bulletin focuses on the accounting arrangements for Police and Crime Commissioners and refers to Chief Constables.
2. Part 1 of the Act contains provisions to abolish Police Authorities and replace them with directly elected Police and Crime Commissioners for each police force outside London. Police and Crime Commissioners will be responsible for securing an efficient and effective police force. The Chief Constable is responsible for maintaining the Queen's Peace and has operational direction and control over the force's officers and staff¹.
3. Both the Police and Crime Commissioners and the Chief Constables have been created under the Police Reform and Social Responsibility Act 2011 as new corporate entities (as Corporations Sole). These corporate entities have also been established as Schedule 2 (Accounts Subject to Audit) bodies under the Audit Commission Act 1998 and as local government bodies in Wales under Section 12 of the Public Audit (Wales Act) 2004.
4. The Accounts and Audit (England) Regulations 2011² require authorities to follow "proper practices in relation to accounts" for the preparation of the Statement of Accounts. The Code of Practice on Local Authority Accounting in the United Kingdom (the Code) constitutes a "proper accounting practice" in England and Wales under the terms of Section 21 (2) of the Local Government Act 2003. Police and Crime Commissioners in England and Wales are defined as local authorities under Section 23 (as amended by the Police Reform and Social Responsibility Act 2011) and will therefore need to follow the Code.
5. At the time of drafting this Bulletin the Accounts and Audit (Wales) Regulations 2005³ (as amended) set out that the Regulations apply to local government bodies defined under Section 12 of the Public Audit (Wales) Act 2004. However, the individual Regulations which refer to the production of the Statement of Accounts currently refer to Police Authorities. Welsh police bodies will need to consider the consultation on the Accounts and Audit (Wales) Regulations 2005 issued on 13th December 2012 to ensure that all of the provisions in the Regulations apply to Police and Crime Commissioners (and Chief Constables) of police forces in Wales⁴.
6. The Home Office Financial Management Code of Practice for the Police Service of England and Wales⁵ sets out that the Chief Financial Officer of the Police and Crime Commissioner will be responsible for ensuring the production of the Statements of Accounts and the Group Accounts of the Police and Crime Commissioner. The legal framework summarised above indicates that the Statements of Accounts including the Group Accounts and the single entity financial statements should be produced in accordance with the Code's requirements.

¹ Police Reform and Social Responsibility Act 2011 (c. 13)

² The Accounts and Audit (England) Regulations 2011, SI 2011 No 817

³ The Accounts and Audit Wales Regulations 2005 SI 2005 No. 368 (W34)

⁴ The consultation closes on 11th January 2013

⁵ Financial Management Code of Practice for the Police Service of England and Wales, Home Office January 2012

7. This LAAP Bulletin highlights the main accounting issues created by the establishment of the policing bodies under the Police Reform and Social Responsibility Act 2011. However, Police and Crime Commissioners will need to consider all the relevant provisions of the Code and the relevant statutory requirements for the production of the Statement of Accounts. This Bulletin is not intended to replace direct reference to these in any way.

ACCOUNTING FOR THE TRANSFER OF FUNCTIONS TO THE NEW BODIES

8. The Police Reform and Social Responsibility Act 2011 allows for the establishment of two new bodies, the Police and Crime Commissioner and the Chief Constable. The 2012/13 Code sets out that a transfer of functions in full from the responsibility of one authority (or other public sector body) to another is required to be accounted for using the principles that apply to group reorganisations. Paragraph 9.1.1.8 of the Code also sets out that:

"the accounting for business combinations (ie subsidiaries and associates) covered by this section [Chapter Nine] of the Code does not apply to ... the transfer of functions from the responsibility of one part of the public sector to another. Merger accounting should be applied where the entity in which the interest has been acquired was 100% in public sector ownership both before and after acquisition by the local authority."

9. The principle established in section 2.5 of the Code is such that local authorities (including Police Authorities) are deemed to be under common control. Therefore, overall government control of the body is unchanged.
10. LAAP considers that there are two possible approaches to the application of merger accounting in the Code which may be considered depending on the individual circumstances of the bodies transferring. These two approaches are considered in more detail below. Further consideration of the application of merger accounting in respect of the police transfer is set out in paragraphs 29-31 below.

Approach A

11. Following the provisions of the Code described in paragraphs 8 and 9 above, the establishment of the police bodies may be accounted for using merger accounting ie per FRS 6 *Acquisition and Mergers*. This is presented in the financial statements by restating the financial performance, position and cash flows of the entities involved as if the service or function performed had always taken place in these entities. Assets and liabilities are required by the Code to be transferred at their carrying amount with certain exceptions specified within paragraph 2.5.2.1.
12. By applying this option, the results and cash flows of Police Authorities will be brought into the financial statements of the receiving Police and Crime Commissioner (and the Chief Constable) from 1 April 2012, adjusted to achieve uniformity of accounting policies. Restatement of comparatives, including that of the results for Police Authorities from the previous period, should be provided in accordance with the Code's adoption of IAS 1 as set out in Section 3.4 *Presentation of Financial Statements* of the Code. Comparatives should be adjusted as necessary to achieve uniformity of accounting policies and consistency of presentation.
13. LAAP considers that if Police and Crime Commissioners apply merger accounting to the financial statements from 1 April 2012, then they are not being accounted for as new bodies, as this accounting treatment presents the new entity as if it has always existed (see paragraphs 8 and 9 above and paragraph 41 of FRS 6). Therefore, the

exemption in paragraph 2.5.4.1 for new authorities from providing corresponding amounts for the previous year would not apply.

14. The Panel considers that the preceding comments would apply to the group accounts and single entity financial statements of the Police and Crime Commissioner, if these bodies apply merger accounting from 1 April 2012. This approach will mean that there will be one set of financial statements for the Police and Crime Commissioner for the full year ending 31 March 2013. It would also mean that no financial statements would be produced for the Police Authority for the financial year 2012/13.
15. It is essential that Police and Crime Commissioners provide relevant information in the financial statements explaining the nature and circumstances of the transfer of functions, the reason that the use of Approach A enables the Police and Crime Commissioner to present a true and fair view of events and transactions and the impact of the transfer on the financial statements. These disclosure requirements are set out in the following paragraphs 16-18.

Reporting Requirements for Approach A

16. The notes and accounting policies of the financial statements should clearly set out the nature, timing and circumstances of the transfer from Police Authorities to the new bodies.
17. The notes to the financial statements should also set out the nature and amount of any adjustments to the transferred assets and liabilities required to achieve uniformity of accounting policies or any other material adjustments required as a result of the transfer.
18. Where Police and Crime Commissioners apply merger accounting to the financial statements from 1 April 2012 (ie Approach A is adopted), LAAP considers that the disclosures in paragraphs 21 and 22 of FRS 6 need to be made in order to ensure that the merged financial statements clearly present the nature of the transactions and events that have taken place to the users⁶ of the financial statements and to ensure the financial reporting supports accountability for the transferring bodies. These disclosures will include;
 - (i) the names of the parties to the transfer of functions
 - (ii) an explanation that the transfer has been accounted for under the merger accounting provisions of the Code
 - (iii) the date of the transfer of functions
 - (iv) an analysis of the principal components of the surplus or deficit on the provision of services pre and post merger
 - (v) the carrying amount of the net assets at the merger date
 - (vi) the disclosures set out in paragraph 17 above
 - (vii) a statement of any adjustment to reserves resulting from the merger

Approach B

19. Where Police and Crime Commissioners (and Chief Constables) consider that the transfer of functions results in the establishment of new police bodies, there is a second approach that needs to be considered.
20. This approach would require that the financial statements of the abolished Police Authorities reflect their results up to the date of transfer whilst the financial

⁶ For example these users may include stakeholders wishing to consider the performance of the PCC including Her Majesty's Revenue and Customs

statements of the new bodies report their results from the date of inception. The assets and liabilities of the Police Authority would be transferred at their carrying amount to the receiving Police and Crime Commissioner (and Chief Constable) as at the transfer date (subject to the exceptions specified in paragraph 2.5.2.1 a) and b) of the Code).

21. For the new bodies/authorities accounting from the date of transfer, paragraph 2.5.4.1 of the Code sets out that no corresponding amounts for the previous year would be required in the financial statements. LAAP is of the view that the notes to their accounts would have to contain information relating to the transfer of functions (see paragraph 25 below for details of the disclosures required).
22. This approach would mean that there would be one set of accounts for the Police and Crime Commissioner for the period from the date of transfer to 31 March 2013 (no comparatives are required). The Police Authority would prepare accounts for the period from 1 April 2012 to the transfer date including comparator information for the previous full year ended 31 March 2012. The Police Authority would need to include appropriate disclosures describing the transfer of functions to the two new bodies and the shortened financial year (see paragraphs 23-24 and 27-28 below).

Reporting Requirements for Approach B

General

23. The notes and accounting policies of the financial statements would have to clearly set out the nature, timing and circumstances of the transfer from Police Authorities to the new bodies.
24. The notes to the financial statements would also set out the nature and amount of any adjustments to the transferred assets and liabilities required to achieve uniformity of accounting policies or any other material adjustments required as a result of the transfer.

New Bodies

25. Paragraph 2.5.4.1 of the Code requires that for new authorities the notes to the accounts of the new authority must include an opening balance sheet reporting the transferred assets, liabilities and opening reserve balances on the creation of the new authority which should be clearly identified as presenting the "transferred" balances as at the date of transfer.
26. Each financial statement and the notes for new authorities should clearly indicate that the current year's results relate to an accounting period of less than 12 months (ie from the date of transfer to 31/03/2013).

Abolished Police Authority

27. Each financial statement and the notes of the abolished Police Authority would have to clearly indicate that the current year's results relate to an accounting period of less than 12 months (eg for the period 1/4/12 to the date of transfer) and that the comparative figures cover a full 12 month period.
28. Details of the nature and circumstances of the transfer of functions would also be disclosed, together with details of the transferred assets and liabilities

Application of the two options

29. Statutory Instrument 2892, The Police Reform and Social Responsibility Act 2011 (Commencement No. 7 and Transitional Provisions and Commencement No. 3 and Transitional Provisions (Amendment)) Order 2012, states that “regulations 7 and 8 of the Accounts and Audit (England) Regulations 2011 shall not apply to a police authority in England established under section 3 of the Police Act 1996 in relation to the financial year beginning on 1st April 2012”.
30. Although Police Authority accounts may be produced from 1st April 2012 to the date of cessation, under Approach B, it appears that there is no statutory requirement for them to be audited for this period. Therefore, where Police Authority accounts for this period are unaudited, Approach B potentially leaves significant gaps in financial accountability for the policing function for the 2012/13 financial year.
31. LAAP considers that the circumstances of this transfer of policing functions, together with the framework surrounding it, particularly that set out above, makes Approach A the preferred option in the case of the transfer of police bodies⁷.

Group Accounts

32. Any group accounts (including the consolidation of any subsidiaries) required to be prepared for the Police and Crime Commissioner would need to be prepared in accordance with Chapter Nine *Group Accounts* of the Code. Additional guidance on the preparation and presentation of Group Accounts is available in *Group Accounts in Local Authorities: Practitioners’ Workbook* (CIPFA, 2011).

POLICE AND CRIME COMMISSIONER SINGLE ENTITY FINANCIAL STATEMENTS

33. The relationship of the Police and Crime Commissioner and the Chief Constable will mean that the Police and Crime Commissioner will need to consider very carefully the income and expenditure, assets, liabilities and reserves that it recognises in its single entity financial statements. It will need to follow the relevant section of the Code in relation to the recognition of these items in the financial statements and is likely to need to consider in depth any formal or informal arrangements for the allocation of resources between the Police and Crime Commissioner and the Chief Constable.
34. It is important to highlight that as with all accounting transactions, Police and Crime Commissioners will 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, it will need to be satisfied that it is able to recognise the land as an asset through control of future economic benefits or service potential that are expected to flow from it as a result of past events.
35. In relation to expenditure the recognition of employee cost (including pensions costs and liabilities) will require careful consideration. Again, Police and Crime Commissioners will need to ascertain which staff are under the control (for accounting purposes) of the Police and Crime Commissioner and where the expenditure would need to be recognised in the financial statements.

⁷ LAAP considers that this recommendation is only relevant to this particular transfer of functions and should not be applied to other transfers of functions.

36. If, for example, categories of staff are employed by the Police and Crime Commissioner, the Commissioner will need to assess whether it controls the outflow of this resource, before recognising the employee costs in the financial statements. This will need 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.
37. It will be important that the Police and Crime Commissioner and Chief Constable establish the incidence of employee expenditure for each of their financial statements as this will influence the identification of the pensions obligations that it will be obliged to meet. It is possible that these obligations will generate the full analysis of IAS 19 costs and assets and liabilities to be recognised in each of the respective financial statements. The Police and Crime Commissioner (and the Chief Constable) may require actuarial assistance to calculate the attribution of pensions costs to each entity. Again, this will be dependent on the incidence of the relevant assets and liabilities in each entity.
38. Chief Constables as Corporation(s) Sole created by the Police Reform and Social Responsibility Act 2011 in England and Wales are also required to follow the Accounts and Audit (England) Regulations 2011 and the Accounts and Audit (Wales) Regulations 2005 (as amended) and will need to consider against the various statutory provisions for their financial reporting requirements the use of the Code as proper practices.