AGENDA ITEM 16

TRANSPORT FOR LONDON

AUDIT COMMITTEE

SUBJECT: UPDATE ON CRITICAL ACCOUNTING POLICIES

DATE: 25 NOVEMBER 2008

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1. PURPOSE

1.1 To update the Audit Committee on the Group's critical accounting policies to be applied in deriving the form and content of TfL's Statement of Accounts for the year ending 31 March 2009.

1.2 This update reflects the impacts of any issues arising during the preparation of the Statement of Accounts for the year ended 31 March 2008, any changes to the Code of Practice on Local Authority Accounting published by CIPFA ("the SORP"), and any other changes to UK accounting and reporting standards which may have an impact on TfL's Statement of Accounts for the year ending 31 March 2009.

2. BACKGROUND

2.1 TfL's Statement of Accounts are prepared in accordance with the provisions of the Audit Commission Act 1998 and the Accounts and Audit Regulations 2006 ("the Regulations"). The form and content followed in preparing the Statement are as prescribed in the Regulations and by the SORP. The accounting policies followed are also substantially as prescribed by the SORP.

2.2 The SORP is updated annually by the CIPFA/LASAAC Joint Committee, a standing committee of CIPFA and LASAAC (Local Authority (Scotland) Accounts Advisory Committee). In deriving the SORP, the Joint Committee follows the Accounting Standards Board's Code of Practice for bodies recognised for issuing SORPs.

2.3 A review of the Group's critical accounting policies first took place in 2004 and has since been updated annually. This paper deals with the critical accounting policies as they relate to the accounts for the year ending 31 March 2009.

3. KEY FEATURES OF THE STATEMENT OF ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2008

3.1 A paper was prepared for the 11 June 2008 Audit Committee. The paper presented the Statement of Accounts for the year ended 31 March 2008. In addition, the Group Accounting Highlights Memorandum was presented to the closed meeting. This provided an explanation of key features of the accounts and details of where the accounting policies or their application had changed since last year's critical accounting policies review.

4. DEVELOPMENTS IN UK ACCOUNTING STANDARDS AND THE 2008 SORP

SORP

4.1 The updated SORP adopted in 2008 ("2008 SORP") reflects the new UK Financial Reporting Standards and Urgent Issues Task Force issues (UITFs) issued prior to 30 September 2007. This new SORP is applicable to TfL's accounts for the year ending 31 March 2009.

4.2 There were no major changes in the 2008 SORP that will impact TfL.

Further UK Accounting Standards developments

4.3 Since 30 September 2007 no new UK Accounting Standards have been issued. There have, however, been amendments to two existing standards:

- Amendment to FRS 20 - Share Based Payments
- Amendments to the Financial Reporting Standard for Small Entities (FRSSE)
- Amendments to FRS 25, 26 and 29 - Financial Instruments: Presentation

4.4 The amendments to FRS 20 and the FRSSE have no impact on the SORP.

4.5 The first amendment to the financial instruments standards relates to the classification of certain puttable financial instruments previously accounted for as a liability now required to be classified as equity. TfL does not have any such instruments.

4.6 The second amendment to the financial instruments standards was issued in response to the credit crisis and allows entities to reclassify certain non-derivative financial assets held for trading in order to hold them at amortised cost. Again, TfL does not have any such instruments.

4.7 In addition, one abstract was published by the Urgent Issues Task Force, relating to hedges of Net Investments in Foreign Operations and as such is not relevant to TfL.

International Financial Reporting Standards

4.8 In the 2007 budget, the Chancellor of the Exchequer announced that the UK public sector would be moving to International Financial Reporting Standards (IFRS) from the year ending 31 March 2009. This includes local authorities and therefore applies to Transport for London.

4.9 In the 2008 budget, it was announced that the implementation of IFRS for central government was to be delayed until the year ending 31 March 2010. The move followed consultations with government departments and with the FRAB [1] on the technical work required.

4.10 TfL will be required to produce IFRS-based accounts information for inclusion in the Whole of Government Accounts (WGA) for the year ending 31 March 2010. It is currently assumed that these accounts will not require prior year comparative information to be restated, as WGA submissions are single year.

4.11 CIPFA announced in January 2008 that full IFRS based accounts are planned for local government for the year ending 31 March 2011. The IFRS based Code of Practice which will replace the SORP will continue to be set by CIPFA/LASAAC. It will, however, be prepared under the oversight of the FRAB rather than the ASB as in previous years.

4.12 TfL has been asked by CIPFA to provide input into the development of the new Code of Practice. Specifically, we will be participating in working groups on group accounts issues and on the new format of the IFRS financial statements.

4.13 Two sets of group accounts will be required for the year ending 31 March 2010. The group's financial statements will be prepared under the UK GAAP-based SORP to the usual timetable. The accounts will then be restated into IFRS for inclusion in the Whole of Government Accounts. The WGA pack will need to be audited and submitted to The Department for Communities and Local Government by 30 September 2010.

[1] The FRAB is the Financial Reporting and Advisory Board and advises on accounting standards for central government departments. It also advises HM Treasury on the implementation of accounting policies specific to Whole of Government Accounts.

4.14 Although the draft 2009 SORP (which will apply to the accounts for the year ending 31 March 2010) is not yet available for comment, we understand from CIPFA that the IFRS-based rules for PFIs from the FReM [2] are likely to be implemented for local authorities for 2010, a year earlier than full IFRS implementation. Work on analysing the Group's PFI and PPP transactions will start as soon as the draft SORP is available. TfL has undertaken to provide feedback to CIPFA on this exercise so that additional guidance can be published as necessary as part of the 2009 SORP.

4.15 Group Financial Accounting is currently working on a project plan and this will be presented to the Audit Committee in March 2009.

5. METRONET

5.1 The Metronet undertakings were transferred to the two TfL Nominee Companies on 27 May 2008.

5.2 Work is continuing to ensure that accounting policies are aligned with those of the TfL Group, and to ensure that all balances between the Nominee companies and London Underground are agreed.

5.3 The opening balance sheet has been reviewed by KPMG, and the acquisition accounting and fair value tables will be completed and reviewed by KPMG in the New Year.

5.4 It is proposed that illustrative Nominee financial statements should be prepared on the basis of quarter three forecasts to ensure that any remaining issues with accounting policies or disclosure are identified and resolved well in advance of the financial year end.

5.5 KPMG has also been appointed as auditor of the two Nominee Subsidiary companies, namely Metronet REW Limited and Metronet TMU Limited, with effect from the year ended 31 March 2008. The audit of these companies is nearing completion and the results of the audit will be reported to the Audit Committee in March 2009.

[2] The FReM is the Government Financial Reporting Manual and applicable to central government departments and is prepared following consultation with the FRAB. Although not currently directly applicable to local authorities, it does set the framework for Whole of Government Accounts reporting. It is therefore expected that the implementation of IFRS for local authorities will be based on the requirements of the FReM.

6. CROSSRAIL

6.1 The Crossrail Bill received Royal Assent in July 2008. The Core Agreements are expected to be signed on 27 November 2008.

6.2 TfL accounted for its interest in Cross London Rail Links Ltd (“CLRL”) as a joint venture at 31 March 2008. Once ownership passes to Transport Trading Limited (“TTL”), TTL will consolidate CLRL and it will be required to use the purchase method of accounting for the acquisition. Ownership of CLRL will transfer within five business days after the core Agreements are signed.

6.3 CLRL was included in the Group’s balance sheet at 31 March 2008 using the “gross equity method” which records the Group’s share of gross assets and gross liabilities. With effect from the date that it becomes a 100% subsidiary, CLRL will be included in the Group’s balance sheet on a line by line basis.

7. TRAMTRACK CROYDON

7.1 On 25 June 2008 TTL acquired Tramtrack Croydon Limited and its two subsidiary companies.

7.2 KPMG has been appointed as auditor to all three companies with effect from the year ended 31 March 2008. The 2008 audit is due to take place in early December and the opening balance sheets will be reviewed as part of the audit. The results of the audit will be reported to the Audit Committee in March 2009.

8. HEDGING PROGRAMME

8.1 Under the Transport for London Act 2008, subsidiaries of TfL were given the power to enter into derivative transactions. A paper was presented to the TfL Board in June this year on TfL’s new hedging powers. The paper described the powers and outlined where the use of derivatives may be appropriate to TfL, together with some of the issues that arise. The paper also included a Policy relating to the Use of Derivative Instruments which set out some details of the powers, as well as arrangements for reporting and governance.

8.2 The Board approved the Policy and the establishment of TfL Finance Limited – a subsidiary of TTL which will primarily carry out the derivative transactions on behalf of the TfL Group, as well as enter into the overarching documents relating to a derivative programme. TfL Finance Limited was incorporated on 10 November 2008. The Board also delegated to the Finance Committee the power to approve derivative transactions under section 49 of the TfL Act 2008 and other related matters.

8.3 Corporate Finance and Group Financial Accounting have conducted research into the possible hedging strategies and corresponding controls. It is expected that approval will be sought from Finance Committee in due course to enter into the first derivative transactions. Accounting advice has been received on the financial statement impact of such transactions. It is likely that TfL will have an option to apply hedge accounting under FRS 26. If hedge accounting were applied, gains and losses will partly be recognised in a Hedging Reserve. The remainder would be recognised in the Income and Expenditure Account.

9. RECOMMENDATION

9.1 The Audit Committee is asked to NOTE the contents of this report.

10. CONTACT

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