AGENDA ITEM 9

TRANSPORT FOR LONDON

AUDIT COMMITTEE

SUBJECT: CHANGES IN ACCOUNTING STANDARDS INCLUDING THE QUARTERLY PROGRESS UPDATE ON THE IFRS PROJECT

DATE: 15 DECEMBER 2010

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1 PURPOSE AND DECISION REQUIRED

1.1 To update the 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 2011.

1.2 To provide the Committee with the quarterly progress update on the International Financial Reporting Standards ("IFRS") project.

1.3 The Committee is asked to note the paper.

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 Code of Practice on Local Authority Accounting 2010/11 published by CIPFA ("the Code"). The Code for 2010/11 is based on IFRS and the Financial Statements for the year ending 31 March 2011 will therefore be prepared under IFRS for the first time. Current and future changes to IFRS's affecting those Statements are dealt with in this paper.

2.2 To support delivery of the first IFRS Financial Statements, the IFRS project has been coordinating the restatement of the 2009/10 comparatives and the opening balance sheet at the transition date, which is 1 April 2009.

3 INTERNATIONAL FINANCIAL REPORTING STANDARDS – TRANSITION UPDATE

Progress to date

3.1 The IFRS project is now focussed on the following key aspects of work:

(a) restated opening balance sheet for all entities as at 1 April 2009;

(b) restated comparative financial statements with full disclosure notes;

(c) confirmation of approach to the transition and assumptions behind the interpretation and practical application of IFRS to TfL entities;

(d) formats of the IFRS financial statements; and

(e) audit of the analysis work done, and the IFRS first adoption adjustments.

3.2 The proposed formats for the IFRS financial statements for the limited company subsidiaries are under review with KPMG, although the format for TfL itself remains work in progress until the CIPFA Guidance notes are issued in December. At this stage it is expected that the only changes will be updates to reflect the changes to IFRS standards during 2010 and the options to early adopt some of the changes approved for future years.

3.3 The IFRS project is still on schedule to present to the Committee the restated IFRS opening balance sheet and comparative financial statements in spring 2011.

3.4 The areas presenting the greatest challenges and potential change at this stage are:

(a) the review of all property holdings and reclassification under the definitions used in IFRS is underway. A practical interpretations paper has been approved by KPMG and a full review to ensure consistency of application is taking place during December. The definition of investment property is slightly different under IFRS and hence the need for review. There is a possibility of change in classification, where property that has previously been treated as infrastructure may now be treated as investment property, and vice versa. Where required, valuations will be undertaken to ensure that the amounts reported in the 2011 Balance Sheet are appropriate;

(b) IFRS requires the capitalisation of interest on borrowings related to qualifying assets. Previously TfL and the subsidiaries have adopted a UK Generally Accepted Accounting Procedures (UK GAAP) - compliant policy of writing interest off to the income statement. For capitalisation to take place a new process is required. Work is underway on designing a process for practical implementation that is not unduly onerous;

(c) the first time adoption of IFRIC 4 Determining Whether an Arrangement Contains a Lease, presents further challenges as the Heathrow T5 and the Northern line Trains contracts amongst others come on balance sheet. The latter is further complicated following the acquisition of Tube Lines, although the work on this area is nearing completion; and

(d) deferred tax is presenting significant challenges. This is only an issue for the subsidiary companies, and on consolidation in the Group accounts. The methodology for calculating the deferred tax asset or liability is different under IFRS and has required significant effort both at TfL and also from KPMG. The methodology is now close to agreement, and the next step is to complete the calculations. It is possible that a net deferred tax liability will result, compared with an asset under UK GAAP. Should this be the case, this liability would normally be provided in the accounts under IFRS even though it is highly unlikely that any tax would ever be payable by the Group. TfL is working with KPMG on the issue of recognition, and the conclusions will be reported back to the Committee in due course.

3.5 KPMG is expected to sign off the Group companies' transition following the audit work in December, and to sign off for TfL in January, following confirmation through the CIPFA guidance notes of any changes to interpretations of the Code.

4 2011 AND IMPENDING CHANGES TO IFRS

4.1 There was one new standard effective for 2009, IFRS 8 Operating Segments, which is applicable to all accounting periods beginning on, or after, 1 January 2009. The interpretation of this standard is not expected to have any material impact on the segments that TfL reports. IFRS 9 Financial Instruments: Classification and Measurement was issued in November 2009 and will be effective from 1 January 2013, however early adoption is not possible until this standard is adopted by EFRAG (European Financial Reporting Advisory Group) as required for all EU countries.

(a) IFRS 8 Operating Segment, supersedes International Accounting Standards (IAS) 14 Segment reporting and requires that an entity whose debt or equity instruments are publicly traded should disclose information about its reportable segments to enable users of its financial statements to evaluate the nature and financial effects of the business activities the entity undertakes. Operating segments are components, or lines of business that are separately financially evaluated by the chief operating decision maker in allocating resources and assessing performance. This standard will affect three entities in the TfL Group, namely TfL itself due to the bond issues, Tube Lines (Finance) Plc, as it has some debt instruments listed in Ireland, and TTL as the holding company of Tube Lines (Finance); and

(b) the International Accounting Standards Board (IASB) has issued IFRS 9 Financial Instruments ('IFRS 9') as the first step in its project to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 will also amend some of the requirements of IFRS 7 Financial Instruments: Disclosures. IFRS 9 introduces new requirements for classifying and measuring financial assets. IFRS 9 will require that financial assets are either measured at amortised cost or fair value. For a financial asset to be held at amortised cost an entity must hold the asset to collect contractual cash flows (as opposed to potentially selling the asset) and the cash flows must solely be for the payment of interest and principal. Any financial assets that do not fulfil these criteria will have to be measured at fair value.

4.2 New interpretations included IFRIC 13 Customer Loyalty Programmes (no effect as Oyster operations do not involve "rewards"), IFRIC 15 Agreements for the Construction of Real Estate (no effect on TfL), IFRIC 16 Hedges of a Net Investment in a Foreign Operation (not applicable), IFRIC 17 Distributions of Non-Cash Assets to Owners (no effect on TfL), IFRIC 18 Transfers of Assets from Customers (no effect on TfL) and IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments (not applicable).

4.3 Various amendments or improvements to standards have been applied for accounting periods in 2009 and 2010. The main amendments are as follows:

Standard / interpretation	**Effective date**	**Summary of change**
IFRS 1	01/07/09	Revisions on first-time adoption and additional exemptions for first-time adopters. The amendments provide two exemptions relating to oil and gas assets, and the determination as to whether an arrangement contains a lease.
IFRS 2	01/01/09 & 01/07/09	Share-based payments – no implications for TfL Group entities anticipated.
IFRS 3	01/07/09	Business combinations - allows a choice on a transaction-by-transaction basis for the measurement of non-controlling interests at the date of acquisition (previously referred to as 'minority' interests) either at fair value or at the non-controlling interests' share of recognised identifiable net assets of the acquiree. The 2008 revisions also changes the recognition and subsequent accounting requirements for contingent consideration, requires the recognition of a settlement gain or loss when the business combination in effect settles a pre-existing relationship between Group and acquire, and requires acquisition-related costs to be accounted for separately from the business combination, generally leading to those costs being recognised as an expense in profit or loss as incurred, whereas previously they were accounted for as part of the cost of the acquisition. IFRS 3 (Revised) will be applied to the reporting of the acquisition of Tube Lines.
IFRS 5	01/01/09	The amendments clarify that all the assets and liabilities of a subsidiary should be classified as held for sale when the Group is committed to a sale plan involving loss of control of that subsidiary, regardless of whether the Group will retain a non-controlling interest in the subsidiary after the sale. The disclosure amendments to IFRS 5 clarify that the disclosure requirements in IFRSs other than IFRS 5 do not apply to non-current assets (or disposal groups) classified as held for sale or discontinued operations except in specific circumstances.
IFRS 7	01/01/09	Confirms the required level of disclosures about credit risk and collateral held and provide relief from disclosures previously required regarding renegotiated loans. Also increases the disclosure requirements for transactions involving transfers of financial assets. These amendments are intended to provide greater transparency around risk exposures when a financial asset is transferred but the transferor retains some level of continuing exposure in the asset. Disclosures are also required where transfers of financial assets are not evenly distributed throughout the period.

Standard / interpretation	Effective date	Summary of change
IAS 1	01/01/09	Clarifies that the potential settlement of a liability by the issue of equity is not relevant to its classification as current or noncurrent, and also that that an entity may choose to present the required analysis of items of other comprehensive income either in the statement of changes in equity or in the notes to the financial statements.
IAS 7	01/01/09	Only expenditures that result in a recognised asset in the statement of financial position can be classified as investing activities in the statement of cash flows.
IAS 23	01/01/09	Eliminates the option to recognise all borrowing costs immediately as an expense. Borrowing costs related to the acquisition, construction or production of a qualifying asset are required to be capitalised as part of the cost of that asset. This represents a change in accounting policy for all TfL entities.
IAS 24	01/01/11	Related Party Disclosures (as revised in 2009) modifies the definition of a related party and simplifies disclosures for government-related entities and in future some counterparties that did not previously meet the definition of a related party may come within the scope of the Standard.
IAS 27	01/07/09	Cost of an investment in a subsidiary, jointly controlled entity or associate. The change to the standard resulted in changes in the Group's accounting policies for changes in ownership interests in subsidiaries that do not result in loss of control.
IAS 28	01/07/09	Consequential amendments were made to IAS 28 as a result of the principle adopted under IAS 27 (2008) that a loss of control is recognised as a disposal and re-acquisition of any retained interest at fair value. Therefore, when significant influence over an associate is lost, the investor measures any investment retained in the former associate at fair value, with any consequential gain or loss recognised in profit or loss. In the 2010 annual improvements IAS 28 (2008) has been amended to clarify that the amendments to IAS 28 regarding transactions where the investor loses significant influence over an associate should be applied prospectively.
IAS 32 & 39	01/02/10 01/07/09	Classification of rights issues and eligible hedged items. Not anticipated to be relevant to TfL Group entities

4.4 Changes that are likely to affect future years include an exposure draft on lease accounting. The proposals would significantly affect the accounting for lease contracts for both lessees and lessors. Lessees would recognise assets and liabilities for all leases; and the current distinction between operating and finance leases would no longer apply. Lessors would apply one of two models, the performance obligation approach or de-recognition approach, depending on whether control and all but a trivial amount of the risks and benefits of the entire underlying asset are transferred to the lessee. There is also the potential for significant deferred tax consequences associated with the adoption of the proposals.

4.5 The final standard is expected in June 2011 and would have a significant impact on TfL borrowings as all leased assets come on balance sheet, with an associated lease creditor. In addition, the impacts on the way in which revenue from rentals would be reported would be significant.

4.6 The Committee will be updated further regarding the impact of the new leasing standard on TfL once the final form of the standard and the timeline for adoption is known.

5 RECOMMENDATION

5.1 The Committee is asked to NOTE the paper.

6 CONTACT

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