AGENDA ITEM 13

TRANSPORT FOR LONDON

AUDIT COMMITTEE

SUBJECT: QUARTERLY PROGRESS UPDATE: THE INTERNATIONAL FINANCIAL REPORTING STANDARDS PROJECT

DATE: 15 JUNE 2010

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1 PURPOSE AND DECISION REQUIRED

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

1.2 To update the Audit Committee on the impact of the changes in accounting policies applicable for the year ending 31 March 2011.

2 BACKGROUND

2.1 With effect from 1 April 2010, Local Authorities are required to prepare their own accounts following IFRS as interpreted by the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 (the “Code”).

2.2 As reported to the Audit Committee in March, the IFRS project has been established to coordinate the transition across the whole of TfL. The purpose of this report is to update the Audit Committee on the status of the IFRS transition project. This report will provide an update on the IFRS accounting policies and details of the key differences between the existing UK-GAAP accounting policies and the proposed IFRS accounting policies.

3 INTERNATIONAL FINANCIAL REPORTING STANDARDS

Progress to date

3.1 The IFRS project has 15 of 20 workstreams active across the Group, with work on three further workstreams underway within the IFRS project team. The remaining workstreams will commence in June following completion of the 2009/10 Accounts.

3.2 The main areas of likely impact have been identified following a strategic review and detailed analysis is underway within modal finance teams to calculate the first adoption adjustments.

3.3 There will be differences in where certain balances are recorded in the Balance Sheet. For example, capitalised software will be reclassified from tangible fixed assets to intangibles.

3.4 TfL is required to comply with the Code and to refer to International Public Sector Accounting Standards (IPSAS) where these provide further guidance.

The subsidiary companies are required to comply with IFRS. A review of the Code, IPSAS and IFRS has been completed to identify any differences between the standards. Where possible, accounting policies have been selected that comply with all three sets of accounting standards to ensure consistency within the TfL group and to minimise the need to maintain separate accounting records. The outcome of the review is documented in section 5.

3.5 The accounting policies have not yet been finalised but a draft of the policies has been reviewed by KPMG and TfL does not expect there to be significant changes to the proposed IFRS policies.

3.6 Proposed formats for the IFRS financial statements are being drafted. Under the CIPFA Code, a complete set of financial statements comprises:

(a) Movement in Reserves Statement for the period;

(b) Comprehensive Income and Expenditure Statement for the period;

(c) Balance Sheet as at the end of the period;

(d) Cash Flow Statement for the period;

(e) Notes, comprising a summary of significant accounting policies and other explanatory information; and

(f) Balance Sheet as at the beginning of the earliest comparative period (i.e. a third Balance Sheet) when an authority applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

3.7 Under the Code, TfL must present with equal prominence all of the financial statements and the order of the first four statements above is recommended but is not required. The financial statements must be presented in the order that best enables users to understand them.

3.8 The format used for subsidiary companies and TfL will differ to reflect the reporting requirements applicable to each.

3.9 In section 4 of this report, we have identified key accounting policies where we expect there to be differences between the current UK-GAAP accounting policy and the proposed IFRS accounting policy.

3.10 In section 5 of this report, we have identified where there is a difference between the Code and IFRS. This difference will result in different accounting treatment of government grants in TfL and the subsidiary companies.

4 EXECUTIVE SUMMARY OF ACCOUNTING POLICIES

Topic	**UK GAAP Policy**	**IFRS Policy**	**Impact of Change**
Capitalisation of borrowing costs on qualifying property, plant and equipment	All borrowing costs are recognised as an expense	Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset and are capitalised A *qualifying asset* is an asset that necessarily takes a substantial period of time to get ready for its intended use There is no specific guidance on how long a substantial period of time is but TfL will be working on the basis that an asset that takes more than one year to get ready for its intended use will be a qualifying asset	There will be a decrease in interest expensed to the Comprehensive Income and Expenditure Statement and an increase to property, plant and equipment additions The capitalisation of interest expense will result in an increased depreciation charge over the life of the asset
Employee benefits	The cost of annual leave is recognised as an expense as the annual leave is taken	The cost of annual leave is recognised as an expense as the annual leave accrues This will result in a provision being recorded at year end for annual leave (and associated on-costs such as national insurance) accrued but not taken	On transition to IFRS an accrual for annual leave will be recorded Once the opening IFRS transition accrual has been recorded, TfL would not expect the value of the accrual to alter significantly in future years. This would mean there would not be a significant impact to the Comprehensive Income and Expenditure Statement post transition

Topic	UK GAAP Policy	IFRS Policy	Impact of Change
Software costs	Capitalised software costs are recorded as a tangible asset rather than as a separate intangible asset	Capitalised software costs that are not an integral part of the related hardware are classified as a separate intangible asset	A review of the asset register will be completed to identify any software costs that should be reclassified from property, plant and equipment to intangible assets
Investment properties	SSAP 19 *Accounting for investment properties* defines an investment property as: An interest in land or buildings: • In respect of which construction work and development have been completed; and • Which is held for its investment potential, any rental income being negotiated at arm's length	IAS 40 *Investment property* defines an investment property as: Investment property is property is property held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for: • Use in the production or supply of goods or services or for administrative purposes • Sale in the ordinary course of business	Given the difference in the definitions of an investment property, a review is in the process of being completed to ensure that all properties are correctly classified in accordance with IFRS

<table>
<tr><th>Topic</th><th>UK GAAP Policy</th><th>IFRS Policy</th><th>Impact of Change</th></tr>
<tr><td>Research and development costs</td><td>Research costs and pure development costs are expensed as incurred

Development costs <u>can be</u> capitalised if all the following criteria can be demonstrated:
There is a clearly defined project
The related expenditure is separately identifiable
The project is technically feasible and commercially viable
It is expected that the project will be profitable
There are available technical, financial and other resources to complete the project</td><td>Research costs are expensed as incurred

Development costs on a project <u>must be</u> capitalised if all the following criteria can be demonstrated:
The project is technically feasible
It is management’s intention to complete the project
It can be demonstrated that the project will generate probable future economic benefits
There are available technical, financial and other resources to complete the project
All project expenditure can be reliably measured</td><td>A review of all potential development projects will be completed

If projects are identified where the five criteria for capitalising development expenditure are met, this expenditure will be capitalised and amortised over the period that revenues are expected to be generated from the project</td></tr>
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Topic	UK GAAP Policy	IFRS Policy	Impact of Change
Assets held for sale	Accounting policy not required under UK-GAAP	An asset or a group of assets containing a non-current asset (a disposal group) is classified as held for sale if its carrying amount will be recovered principally through sale rather than through continuing use, it is available for immediate sale and sale is highly probable within one year On initial classification, a disposal group is valued at the lower of previous carrying value and fair value less costs to sale with any adjustments being taken to the Comprehensive Income and Expenditure Statement	A review will be completed to identify any assets held for sale Any assets held for sale that are identified will be separately classified as a current asset disposal group Examples of assets that might be classified as held for sale include: • Those assets being considered under the Asset Financing Strategy • A property that TfL is planning to dispose of

Topic	UK GAAP Policy	IFRS Policy	Impact of Change
Leases	A finance lease is a lease that transfers substantially all the risks and rewards of ownership of an asset to the lessee. It is presumed that the lease is a finance lease if at the inception of the lease the present value of future lease payments amounts to 90% or more of the fair value of the asset.	A finance lease is a lease that transfers substantially all the risks and rewards of ownership of an asset to the lessee When considering whether a lease is a finance lease, the following factors would normally lead to a lease being classified as a finance lease: • Ownership of the asset transfers to the lessee at the end of the lease • The lessee has an option to purchase the asset at a price that is below fair value • The lease term is for the major part of the asset's economic life • At the inception of the lease, the present value of future lease payments amounts to substantially all of the fair value of the asset • The asset is of such a specialised nature that only the lessee could use it without major modifications	All material leases will be reviewed to ensure that they have been correctly classified in accordance with IFRS This could potentially lead to some leases being reclassified from operating lease to finance lease This would result in an increase in non-current assets and a corresponding increase in finance lease creditors
Business combinations – transaction costs	The transaction costs incurred in completing a business combination are included in the cost of acquisition (which will result in additional goodwill being recorded on acquisition)	All transaction costs incurred in completing a business combination must be expensed as incurred	All transaction costs incurred on the acquisition of Tube Lines will be expensed as incurred

Topic	UK GAAP Policy	IFRS Policy	Impact of Change
Business combinations – merger accounting	Where allowable under UK-GAAP merger accounting principles are applied to group reconstructions. When merger accounting, the carrying values of assets and liabilities are not required to be adjusted to fair value on acquisition	IFRS requires that acquisition accounting is used for all business combinations. This method requires that a fair value exercise is completed for all identifiable assets and liabilities of the acquired entity	There have been no acquisitions since the IFRS transition date of 1 April 2009 which means that this change of accounting policy will not result in any business combinations being restated Under IFRS 1 *First-time adoption of IFRS*, there is the option to restate pre-transition date acquisitions. TfL will not be taking advantage of this option As the acquisition of Tube Lines will take place post transition, it will be accounted for using acquisition accounting principles in accordance with IFRS3 *Business Combinations*
Goodwill	Goodwill is amortised over a 20 year period	Goodwill is not amortised but must be tested for impairment on an annual basis	This will not impact TfL unless there is goodwill recognised on the acquisition of Tube Lines or any future acquisitions

Topic	UK GAAP Policy	IFRS Policy	Impact of Change
Related party disclosures	Subsidiary companies who have 90% of their voting rights controlled within the group are exempt from disclosing related party transactions	There is no exemption for subsidiary companies under IAS 24 *Related Party Disclosures* ("IAS 24") A revised IAS 24 has been issued (but not yet endorsed by the EU) which can be early adopted which allows reduced related party disclosure for government-related entities	There will be additional related party disclosures in the subsidiaries of TfL as they will no longer be exempt from completing this disclosure The revised IAS 24 is expected to be endorsed in mid 2010 and will potentially result in less related party disclosure in TfL and its subsidiaries as they will be classified as government-related entities
Cashflow statements	Subsidiary companies who have 90% of their voting rights controlled within the group are exempt from completing a cash flow statement	There is no exemption for subsidiary companies under IAS 7 *Statement of cash flows*	Cash flow statements will have to be completed for all statutory entities

5 DIFFERENCES BETWEEN THE CODE, IPSAS AND IFRS

Topic	The Code/IPSAS (TfL)	IFRS (Subsidiaries)	Impact of Change
Capital government grants	Capital grants received are taken straight to the comprehensive income statement (subject to the conditions of the grant being met) Capital grants should not be deferred on the balance sheet	Capital grants received are initially recorded as deferred income on the balance sheet and then released to the profit and loss account over the useful life of the asset to which it relates (subject to the conditions of the grant being met)	***TfL*** All capital grants deferred on the balance sheet will be written back to reserves at IFRS transition date. This will increase the net assets of the TfL group by £6.9 billion on transition to IFRS All capital grants received after IFRS transition date will credited straight to the Comprehensive Income and Expenditure Statement and transferred to the Capital Adjustment Account ***Subsidiaries*** No change from UK-GAAP

6 RECOMMENDATION

6.1 The Audit Committee is asked to NOTE the report.

7 CONTACT

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