Audit and Assurance Committee

Date: **20 September 2023**

Item: **TfL Annual Report and Statement of Accounts for the Year Ended 31 March 2023**

This paper will be considered in public

1 Summary

1.1 This paper presents the Annual Report and draft TfL Group Statement of Accounts for the year ended 31 March 2023 and requests the Committee's approval of the Statement of Accounts for the year ended 31 March 2023 and their publication.

1.2 On 25 July 2023, the Board approved the Annual Report. The Board also considered the draft Statement of Accounts, recognising that a decision on the approval could not be made until the resolution of several outstanding matters and delegated their approval to the Committee.

1.3 Given the significant work required, and the short timescales involved, the Independent Auditor's (Ernst and Young LLP, EY) Report remains in draft at the time of publishing this paper. A verbal update will be given to the Committee should there be any changes to the draft Independent Auditor's Report from EY that is presented and the final copy will be submitted to the next meeting of the Committee.

2 Recommendations

2.1 The Committee is asked to note the paper and:

(a) approve the 2022/23 Statement of Accounts, subject to any comments Members may have, and authorise the statutory Chief Finance Officer to make any adjustments arising from the findings of the auditors, Ernst & Young LLP, prior to signing their opinion. Should any changes be required to the Statement of Accounts which, in the opinion of the statutory Chief Finance Officer. are material, they will seek approval of the Committee for these changes;

(b) note that the Chair of the Committee will sign and date the Statement of Accounts in due course; and

(c) note that the level of Minimum Revenue Provision has been made in the Statement of Accounts in accordance with the policy approved by the Board.

3 Background

3.1 TfL is required under section 161 of the Greater London Authority Act 1999 (the GLA Act) to produce a report on its achievements and the performance of its functions during the year. Approval of the Annual Report is a matter reserved to the Board under TfL's Standing Orders. The Annual Report includes the information that is required under the GLA Act.

3.2 TfL is also required, under the Accounts and Audit Regulations 2015 (the Regulations) to prepare a Statement of Accounts each year. The Statement of Accounts has been prepared in accordance with the provisions of the Regulations and the Local Audit and Accountability Act 2014. The form, content and accounting policies followed in preparing the Statement of Accounts are as prescribed in the Regulations and by the Code of Practice on Local Authority Accounting which is developed and published by the CIPFA/LASAAC joint committee (the Code). The Code is based on International Financial Reporting Standards (IFRS).

3.3 The 2022/23 TfL Annual Report is combined with the TfL's Statement of Accounts for the year ended 31 March 2023. While it is not a legal requirement to combine these documents, it is regarded as good practice and will assist key audiences in understanding TfL's financial and operational performance over the year. The structure of the report has been designed for the web and it will be available on TfL's website, electronically and in other formats on request.

3.4 The draft Statement of Accounts (unaudited) was certified by the statutory Chief Finance Officer and published on the tfl.gov.uk website on 1 June 2023 as part of the papers for the Committee's meeting on 5 June 2023, with the Annual Governance Statement. Appropriate notices were placed on TfL's website, and media briefings were offered. The period for exercise of public rights was commenced on 2 June 2023 and concluded on 13 July 2023.

3.5 On 5 June 2023, the Committee considered the draft Statement of Accounts for the year ended 31 March 2023. Comments made by the Committee have been addressed in the documents.

3.6 On 25 July 2023, the Board approved the Annual Report and authorised the Chief Customer and Strategy Officer to make any further design or editorial changes as may be required.

3.7 At the time of the Board meeting on 25 July 2023, several matters were outstanding with the Statement of Accounts. The Board considered the draft Statement of Accounts but did not approve it, with approval authority being delegated to the Committee instead.

3.8 The Regulations require that the Statement of Accounts is approved by a resolution of a committee or by members meeting as a whole. Approval of the Statement of Accounts is a matter ordinarily reserved to the Board under TfL's Standing Orders, paragraph 99(c). On 25 July 2023, the Board delegated approval of the Statement of Accounts to the Committee. To facilitate this, Standing Order 108 was disapplied as part of the Board delegation.

4 Changes Since the Committee Meeting on 5 June 2023

4.1 The financial results for 2022/23 and the notable elements of the Statement of Accounts were outlined in the paper to the Committee on 5 June 2023. However, since this date, there have been a number of changes to the draft Statement of Accounts. These are outlined below.

Confirmation of Funding for 2023/24 and Revenue Top-Up for 2022/23

4.2 The financial statements have been prepared on a going concern basis as the Board remains confident that TfL will continue in operational existence from the date of signing these financial statements at least until 31 March 2025 and will meet its liabilities as they fall due for payment.

4.3 The disclosures have been updated to reflect the confirmation of funding for 2023/24. The Department for Transport (DfT) was not in a position to provide a specific inflation uplift. However, there was partial mitigation through an increase to the revenue top-up mechanism. This included a recalculation of the DfT revenue top-up funding relating to 2022/23, which resulted in an uplift to the revenue grant of £23m. This has been reflected in the latest version of the accounts.

4.4 The implications of the remaining shortfall in inflation funding are still being worked through and will be reported to a future meeting of the Finance Committee. However, the scale of the funding shortfall does not represent a risk to TfL’s going concern status.

4.5 In TfL’s 2021/22 Statement of Accounts, a material uncertainty was disclosed as to the level of longer-term funding support that would be agreed, and what this meant for the shape of TfL’s planned future activities. The uncertainty at that point in time cast significant doubt over TfL’s ability both to continue operating the level of services currently provided and to continue with all projects included in the capital investment plan.

4.6 For the year ended 31 March 2023, management has revisited the relevant risk factors and concluded that there is no longer material uncertainty on the basis that:

(a) over the past 11 months there has been no reductions in funding by DfT under the August 2022 settlement and TfL have delivered against the funding conditions. As such the risk of dispute is reduced; and

(b) TfL stretched its business plan savings target to £600m to 25/26, delivering an additional £27m in 2022/23 compared to its target of £65m and is making good progress towards its £204m target in 2023/24. Therefore, while a risk of delivering the full savings target remains, it has reduced.

4.7 The current Government funding settlement expires on 31 March 2024 and there is no certainty on future capital funding support from Government. However, the Government has consistently recognised that TfL cannot solely finance investment in major capital projects and renewals (i.e. rolling stock and signalling) from its own operating incomes. TfL is currently in discussions with Government over the quantum of capital funding provided in 2024/25 to contribute towards rolling stock and signalling programmes.

Sandilands and ULEZ Judgments

4.8 At the time the Statement of Accounts was presented to the Board on 25 July 2023, the sentencing of TfL in relation to the 2016 Sandilands tram derailment was ongoing, as was the judicial review by five Borough Claimants of the decision to expand the Ultra Low Emission Zone (ULEZ).

4.9 On 27 July 2023, TfL was sentenced and fined £10m in relation to the Sandilands tram derailment. TfL also was required to pay £234,404 towards the prosecuting authority's legal costs. The amounts have been reflected as a provision in the accounts as at 31 March 2023.

4.10 There was no change to the accounts resulting from the judicial review regarding the decision to expand ULEZ, in which TfL was successful.

Public objection – Red Route Bay Enforcement

4.11 On 11 July 2023, during the public inspection period for the Statement of Accounts, a local elector submitted an objection to EY, our external auditors. This was in relation to the legality of remote enforcement of red route parking bay contraventions using CCTV.

4.12 On 17 July 2023, the Chief Adjudicator of the London Tribunals refused TfL's application to review a decision by a panel of Parking Adjudicators that red route bay contraventions cannot be enforced remotely using CCTV.

4.13 TfL has been given permission to judicially review this determination at the High Court. The hearing is expected to take place after the signing of these financial statements.

4.14 A contingent liability relating to this matter has been disclosed in Note 31 of the accounts. The potential undiscounted amount of the total payments the Group could be required to make is between £40m to £50m for penalty charge notices (PCNs) issued and paid since the Civil Enforcement of Parking Contraventions (England) General (Amendment) Regulations 2020. Uncertainties exists with determining the number of PCNs that would form part of any ruling and the proportion of those that would be repaid or reclaimed.

Other Provisions

4.15 Additional contractual and compensation provisions of £59m have been raised relating to a separate matter, the details of which are commercially sensitive.

Minimum Revenue Provision

4.16 As part of their audit work, EY undertook a detailed review of TfL's Minimum Revenue Provision (MRP) policy since 2005/06 under the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (the Capital

Finance Regulations) and the applicable Statutory Guidance on Minimum Revenue Provision issued by the Secretary of State under section 21(1A) of the Local Government Act 2003 (the Guidance).

Context

4.17 MRP is the requirement for a local authority to make a charge against its General Fund to set aside a provision for the repayment of borrowing and credit arrangements (including leases). Under the Capital Finance Regulations, the local authority must determine the amount of MRP which it considers to be prudent, having regard to the guidance in force at that time.

4.18 The Guidance requires that before the start of each financial year a local authority should prepare a statement of its policy on making MRP in respect of that financial year and submit it to full Council for approval. The statement should describe how it is proposed to discharge the duty to make prudent MRP during that year. For local authorities without a full Council, the statement should be presented for approval at the closest equivalent level, therefore, for TfL, the MRP policy is approved by the Board.

4.19 The Guidance has changed several times since it was first issued. In 2008, the Guidance was amended to allow authorities flexibility in determining their MRP charge required so long as they ‘have regard to’ the Guidance. In 2007/08 TfL’s policy was changed so that no MRP was to be provided given the TfL’s requirement to have a balanced business plan that included repayments of debt. This was considered prudent by management and approved by the Board. At the time, legal advice was obtained by TfL to confirm that this approach was lawful under the Capital Finance Regulations and the 2008 version of the Guidance.

4.20 In March 2016, the Board approved a change to the policy to start providing MRP using one of the recommended options in the Guidance (Option 3 – Asset Life Method). The policy has remained unchanged since that point, although the MRP policy is reviewed and re-approved each year by the Board.

Prospective application

4.21 The Asset Life Method requires local authorities to charge MRP as a proxy for depreciation, which is an accounting estimate. Therefore, when changing the MRP approach, the Guidance states that local authorities should follow proper accounting practices when changing an accounting estimate, which means that changes should be applied prospectively.

4.22 For example, in depreciation accounting, when an entity reassesses the life of an asset, it does not recalculate the depreciation it has charged from acquisition of the asset. Instead, depreciation must be recalculated over the revised asset life using the current net book value of the asset as the new starting point.

4.23 Therefore, when the change was made to MRP policy in 2016, the change was applied prospectively to historic borrowings. To compensate for this, the recognition of MRP was accelerated for historic borrowings to reflect the shorter remaining asset lives that the borrowing was used to finance.

Application to subsidiaries

4.24 The MRP policy first approved by the Board in March 2016 is to not provide MRP on borrowing passed down to TfL subsidiaries. The rationale for this is the Corporation already funds the depreciation of assets in the subsidiaries through revenue grants given each year. This revenue grant is charged against the General Fund of the Corporation.

4.25 As MRP is designed to act as a proxy for depreciation, also charging MRP on borrowings passed to subsidiaries would effectively mean the Corporation's General Fund was being charged twice.

4.26 The majority of loans to TfL's subsidiaries have been used to fund infrastructure for Crossrail and upgrades to the London Underground. These services are now generating an operating surplus, which will fund these debt repayments in future. The forecast is for these operating surpluses to grow over time as demand continues to recover from the pandemic and operating savings continue to be delivered.

Prior period error

4.27 During the audit of TfL's historical MRP calculations a prior period error was discovered in relation to the A13 Road Private Finance Initiative (PFI) contract. The assets became available for use in 2006/07. However, the related MRP charge only commenced in 2019/20 when MRP commenced for all leases (including PFIs) on the adoption of IFRS 16.

4.28 The annual charge for the A13 PFI was calculated as the annual level of depreciation. However, this did not reflect that the asset had already been in use since 2006/07, therefore the remaining useful asset life had already been reduced. Therefore, a prior period error adjustment of £47.1m has been recorded in the Statement of Accounts to correct for this. This results in a decrease of usable reserves and a corresponding increase in unusable reserves and ensures that the MRP in relation to the PFI is aligned with the remaining service potential of the assets.

Consideration of prudence

4.29 The Capital Finance Regulations require authorities to determine an amount of MRP which they consider to be prudent.

4.30 The cumulative MRP reserve of £324.6m as at 31 March 2023 is considered to be prudent because it has been:

(a) calculated in-line with one of the recommended options set out in the Guidance;

(b) matched to the service potential of the assets that the borrowings have been used to fund (including PFI and lease borrowing); and

(c) matched to the weighted average lifetime of TfL’s debt. (At the current rate of provision, the Corporation will have achieved 100 per cent coverage of its borrowings by 2040/41, which is 19 years’ time. The weighted average maturity of TfL debt is 19 years).

Future considerations

4.31 The Capital Finance Regulations require local authorities to prepare a statement of policy on MRP each financial year, but they are not prescriptive on the content or level of detail required.

4.32 TfL has a policy which is reviewed and approved by the Board on an annual basis, therefore is compliant with the Capital Finance Regulations. However, given the complexity of this area and the uniqueness of TfL as a local authority, there is the potential that the policy could be strengthened.

4.33 Therefore, a more in-depth review of the MRP policy, potentially involving external specialist support, will be completed ahead of presenting the policy for 2024/25 to the Board in March 2024.

Other Changes and Audit Matters

4.34 The draft Independent Auditor’s report was not incorporated into the draft that was provided to the meeting of the Committee on 5 June 2023 as the auditors had not completed their audit work at that time.

4.35 Throughout the remainder of the Statement of Accounts there were various updates to disclosures as part of the EY audit and immaterial changes for consistency, disclosure amendments and formatting to enhance compliance with the Code.

Reconciliation from draft Statement of Accounts presented to the Committee on 5 June 2023	**£'m**
Group surplus on provision of services after tax	108.6
Increase in provisions estimates	(59.2)
DfT Revenue top-up adjustment	23.0
Sandilands provision adjustment	(2.2)
Adjustments to share of loss from investment in associate	(2.1)
Deferred tax adjustment on investment properties	6.1
Other minor adjustments	(0.4)
Adjusted group surplus on provision of services after tax	**73.8**

5 Subsidiary Companies Audit Exemption

5.1 For the year ended 31 March 2014, the Group took advantage of changes under section 479A of the Companies Act 2006 that enable certain UK subsidiary companies to claim exemption from audit of their accounts.

5.2 The exemption is conditional on a parent undertaking giving a guarantee to its subsidiary in respect of all liabilities of that subsidiary outstanding at the balance sheet date, and on 5 June 2014, under authority delegated by the Board on 26 March 2014, the then Finance and Policy Committee agreed that, for the year ended 31 March 2014 and for future years until withdrawn, the holding company for TfL's trading subsidiaries, Transport Trading Limited (TTL), will offer the guarantee to a majority of its subsidiaries.

5.3 For the year ended 31 March 2023, the majority of TTL's subsidiaries claimed exemption from audit, save that, in line with the financial separation of TfL's property arm, the guarantee from TTL to TTL Properties Limited (now Places for London Limited) and its subsidiaries was withdrawn. Places for London Limited provides a section 479A guarantee in respect of the majority of its subsidiaries.

List of appendices to this report:

Appendix 1: Annual Report and Draft Statement of Accounts 2022/23

List of Background Papers:

Audit Exemption for Subsidiary Companies – Finance and Policy Committee paper June 2014.

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