Audit and Assurance Committee

Date: **14 June 2016**

Item: **EY Report to Those Charged with Governance**

This paper will be considered in public

1 Summary

1.1 To report to the Audit and Assurance Committee the key issues identified by Ernst and Young (EY) during the course of their audit of the Statement of Accounts for the Transport for London Group for the year ended 31 March 2016.

2 Recommendation

2.1 **The Committee is asked to note this report.**

3 Background

3.1 EY have, as required by International Auditing Standards, prepared a report for the benefit of those charged with governance. The report outlines the respective responsibilities of the auditor and TfL, and provides an overview of the status of the audit and accounting policy changes. The report also comments on judgemental areas within the accounts. EY's report is attached for the Committee's review.

List of appendices to this report:

Appendix 1: EY's Report to Those Charged with Governance

List of Background Papers:

None

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Appendix 1

Transport for London Group

Audit and Assurance Committee Summary

For the year ended 31 March 2016

Audit Results Report – ISA (UK & Ireland) 260

27 May 2016

Building a better
working world

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The National Audit Office's Code of Audit Practice (the Code) and International Standards on Auditing (UK and Ireland) require us to report to those charged with governance (the Audit and Assurance Committee) on the work we have carried out to discharge our statutory audit responsibilities together with any governance issues identified.

This report summarises the findings from the 2015/16 audit which is substantially complete. It includes the feedback arising from our audit of your financial statements, based on the work completed to date, and the results of the work we have undertaken to assess your arrangements to secure economy, efficiency and effectiveness in your use of resources.

Financial statements

- We received the draft 2015/2016 TfL Group financial statements on the 16 May 2016. As of 27 May 2016, our audit work on the TfL Group financial statements is still in progress. Details of those sections in progress are noted on page 15 of this report. Based on our audit findings to date, we expect to issue an unqualified opinion on the financial statements. We will provide a verbal update on further progress at the Audit Committee meeting. We have made some observations on the control environment resulting from our financial statement audit included on pages 17 and 18.
- We have no unadjusted audit differences to report at the date of writing this report.

Value for money

- Our review of TfL's arrangements to secure economy, efficiency and effectiveness in its use of resources is complete. Overall we have found that TfL have made appropriate arrangements to secure economy, efficiency and effectiveness in its use of resources, however our report provides additional observations for TfL to consider, details of which are held on pages 19 to 23 of this report.
- We will also provide a separate report of the work performed by Internal Audit on the Garden Bridge procurement. Work is nearing completion, but as of today's date the report has not been through management review. An update will be provided at the Audit Committee.

Executive summary

Key findings

Audit results and other key matters (continued)

Whole of government accounts

- We have performed our audit to date with Whole of Government (WGA) requirements in mind and we aim to complete the remainder of our work on the WGA by August 2016 in order to meet the deadline of 30 September 2016.

Audit certificate

- The audit certificate is issued to demonstrate that the full requirements of the National Audit Office's 2015 Code of Audit Practice have been discharged for the relevant audit year. We expect to issue the audit certificate in August 2016 once the work on Whole of Government Accounts is complete.

Extent and purpose of our work

TfL's responsibilities

- TfL is responsible for preparing and publishing its Statement of Accounts, accompanied by the Annual Governance Statement (AGS). In the AGS, TfL reports publicly on the extent to which it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in the year, and on any planned changes in the coming period.

- TfL is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Purpose of our work

- Our audit was designed to:
  - Express an opinion on the 2015/2016 TfL Corporation, Group and TTL Group financial statements and the consistency of other information published with them
  - Report on an exception basis on the Annual Governance Statement
  - Consider and report any matters that prevent us being satisfied that TfL Corporation had put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources (the Value for Money conclusion)
  - Discharge the powers and duties set out in the Local Audit and Accountability Act 2014 and the Code of Audit Practice, in respect of TfL Corporation.

- In addition, this report contains our findings related to the areas of audit emphasis, our views on TfL's accounting policies and judgments and significant deficiencies in internal control.

- As a component auditor, we also follow the NAO group instructions and report the results on completion of the WGA work through the Assurance Statement to the NAO and to TfL.

- This report is intended solely for the information and use of TfL. It is not intended to be and should not be used by anyone other than this specified party.

Addressing audit risks

Significant audit risks

We identified the following significant audit risks during the planning phase of our audit, and reported these to you in our Audit Plan. Here, we set out how we have gained audit assurance over those issues.

Audit risk identified within our Audit Plan	Audit procedures performed	Assurance gained and issues arising
Significant audit risks (including fraud risks)		
Risk of fraud in revenue recognition. 1. Management is in a unique position to perpetrate fraud because of their ability to directly or indirectly manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every engagement under ISA (UK & Ireland) 240.	For TfL and TTL groups and subsidiaries, we have: ► Tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. ► Reviewed accounting estimates for evidence of management bias. ► Reviewed the business rationale for unusual transactions. ► Considered the effectiveness of management's controls designed to address the risk of fraud. ► Understood the oversight given by those charged with governance of management's processes over fraud.	Our planned procedures in relation to this risk are substantially complete. There are no issues to report to the Committee at this stage.
Inappropriate Revenue recognition, required by ISA (UK & Ireland) 240 2. TfL need to have robust controls in place to forecast and accurately recognise and report revenue in its financial statements, including: ► £4.6billion fare revenue (2015/16) generated by cash and contactless payments. ► £3.5billion of grant funding (2015/16) to support TfL's financial plans, investment programmes and the Crossrail project. ► Commercial development, including advertising and property rental and development.	For TfL and TTL groups and subsidiaries, we have: ► Reviewed KPMG's preliminary ISAE3402 report and agreed procedures report, and expect to be able to place reliance on their work performed. ► Tested grant funding to assess if revenue had been recognised in accordance with the agreement and conditions set. ► Performed cut-off procedures and audited deferred income. ► Transaction tested where we are not able to place reliance over the controls in place or where procedures above were not sufficient.	Our planned procedures in relation to this risk are substantially complete. At the date of this document we have reviewed KPMG's preliminary ISAE3402 report, and expect to be able to place reliance on their work performed once finalised in June 2016. There are no issues to report to the Committee at this stage.

Addressing audit risks

Significant audit risks (continued)

Audit risk identified within our Audit Plan	Audit procedures performed	Assurance gained and issues arising
Significant audit risks (including fraud risks)		
Inappropriate capitalisation or potential impairment of capital projects 3. TfL, TTL and subsidiaries undertake multiple capital projects at any one time which vary in size, complexity and length of time to complete. TfL's total capital expenditure was £4.1billion. 80% of this spend related to both major station, tube and new train stocks projects ongoing across London Underground and the implementation of the Crossrail project. Judgements and controls needs to be effective to appropriately recognise the revenue costs from these significant projects including: ► Appropriate split of costs between capital and operating expenditure. ► Assessment of the economic useful lives of the asset where costs are capitalised. ► Whether to recognise impairments and write-offs for assets to reflect either increased risks of projects being terminated or suspended.	For TfL and TTL groups and subsidiaries, we have: ► Reviewed thirteen major projects (including Crossrail) based on quantitative and qualitative thresholds. ► Understood key controls and governance surrounding capital project accounting and management. ► Met with management and project managers at P9, P11 and P13 as well as attending management's P12 accruals meetings. ► Evaluated management's judgements and assumptions used in determining the future benefits expected from the projects and ensured they are appropriate and supportable. ► Reviewed all risk registers for selected projects to ensure existence and completeness of FY16 balance sheet provisions. ► Considered pain/gain shares. ► Reviewed whether or not capitalisation of costs is appropriate. ► Considered whether at any stage assets need to be impaired or written off to reflect any aborted or higher risk projects. ► Performed detailed testing on a sample of expenditure incurred and capital accruals to source documents.	Our planned procedures in relation to this risk are ongoing and due for completion by 27 May 2016. Based on our work, including meeting attendance and knowledge of the underlying contracts, we challenged management on the judgements and estimates made, and are satisfied with management's judgements. There are no issues to report to the Committee.

Addressing audit risks

Significant audit risks (continued)

Audit risk identified within our Audit Plan	Audit procedures performed	Assurance gained and issues arising
Significant audit risks (including fraud risks)		
Significant accounting estimates – complexity of provisions and accruals 4. Certain provisions and accruals (e.g. Compulsory Purchase Orders, litigation, claims and disputes) require complex estimates involving high levels of management judgement and uncertainty. TfL, TTL and subsidiaries have complex contract and commercial arrangements. A large proportion of TfL corporations provisions (£120.6million as at 31 March 2016) come from its capital investment activities.	For TfL and TTL groups and subsidiaries, we have: ► Reviewed material provisions and accruals for business purpose and appropriateness of estimation techniques. ► Calculated the sensitivity of the provisions to changes in assumptions used for discount rates and inflation to determine if this is material. ► Reviewed and critically evaluated management's judgement and estimates applied in the calculation of provisions in the financial statements.	Our planned procedures in relation to this risk are ongoing and due for completion by 27 May 2016 subject to satisfactory clearance of remaining queries. Identified errors totalling £6.5m have been agreed and adjusted for by management. None of these individually were above our materiality threshold. CPO provisions and contractual disputes are subject to significant estimation techniques and include uncertainty around negotiations and the fact that the circumstances of the other party will ultimately determine both the timing and level of settlement. As a result further disclosure has been requested regarding the level of uncertainty associated with CPO provisions in particular.

Addressing audit risks

Significant audit risks (continued)

Audit risk identified within our Audit Plan	Audit procedures performed	Assurance gained and issues arising
Significant audit risks (including fraud risks)		
Complexity of accounting and disclosures for TfL's borrowing and treasury management 5. TfL has significant and complex arrangements for borrowing and treasury management which need to be accounted for and disclosed appropriately. In particular: ► Through a wholly owned subsidiary, TfL holds a portfolio of derivatives to hedge interest rates and risks on its issued and future borrowings and for lease of rolling stock. ► TfL has diversified its investment portfolio. For the first time in 2014/15, TfL invested in approved counterparties in Euros and US Dollars. ► TfL must keep its borrowing within prudential limits set by the Mayor as part of Greater London Authority's consolidated budget for its functional bodies and the requirements of the Local Government Act 2003.	We have: ► Reviewed TfL's borrowing portfolio and compliance with its prudential indicators. ► Assessed the reasonableness of TfL's borrowing, against its financial, business plans as part of our assessment of going concern. ► Reviewed and where appropriate challenged management's assessment on hedge forecasting. We have involved our EY Treasury expert to review managements assumptions. ► Reviewed accounting policies and disclosures against IAS39 and IFRS7.	Our planned procedures in relation to this risk are substantially complete. Our Treasury specialist is in the process of concluding on the appropriateness of management's assumptions. We are also still waiting for some 3rd party confirmations from the counterparty banks/ institutions before we can finalise this work. We are not anticipating any issues based on our work to date. Our work on Crossrail identified an audit difference in the accounting treatment for an interest free loan provided to Network Rail. We consider that the provision of an interest free loan should have an impact on profit and loss rather than a balance sheet receivable as currently accounted for.

Addressing audit risks

Significant audit risks (continued)

Audit risk identified within our Audit Plan	Audit procedures performed	Assurance gained and issues arising
Significant audit risks (including fraud risks)		
Complexity of accounting for TfL and TTL property portfolio 6. TfL and TTL groups have an extensive property, plant and equipment portfolio, with a total book value of £35billion as at 31 March 2016. Included within the portfolio are infrastructure and office buildings, rolling stock, plant and equipment, investment properties, and assets under construction. Assets which are subject to valuation include investment properties and office buildings. The unique and material nature of TfL and TTL groups' property portfolio means that small changes in assumptions when valuing these assets can have a material impact on the financial statements.	For TfL and TTL groups and subsidiaries, we have: ► Discussed with management and reviewed evidence to gain an understanding of TfL and TTL group property portfolio. ► Discussed and reviewed valuation assumptions made by DTZ, Cushman & Wakefield along with the TfL Property team. ► Performed substantive testing and corroborated explanations for property additions, disposals and accounting for lease contracts. ► Assessed the classification of TfL and TTL property portfolio, the valuation basis and any material increases or impairments that have arisen during 2015/16. ► Assessed the work of TfL's property valuers. We have used our EY Estates team as appropriate to review and test the accounting entries and disclosures made in the financial statements. ► Reviewed Infrastructure and office buildings, PFI accounting models and appropriateness of accounting and disclosures. We have used our EY Estates team and PFI experts as appropriate to review and test the accounting models.	Our planned procedures in relation to this risk are in progress. We are awaiting: ► the final valuation report from Cushman & Wakefied which is due at the end of May 2016. ► responses to queries on the PFI model input assumptions. We note that the commercialisation programme is still in its early phase of implementation. With assets potentially changing in use, significant valuation movements are likely in future years accordingly. We will keep this as a focus area for our 2016/2017 audit, and note that few such changes have occurred in the current year.

Addressing audit risks

Significant audit risks (continued)

Audit risk identified within our Audit Plan	Audit procedures performed	Assurance gained and issues arising
Significant audit risks (including fraud risks)		
Judgmental assumptions impacting on TfL's pension deficit 7. As at 31 March 2016, TfL's defined pension scheme has a deficit of £3.2billion. The TfL Group balance sheet includes the deficit on the Public Sector and Tube lines section of the TfL Pension Fund, TfL's share of the deficit on the Local Government Pension Scheme and liability for unfunded pensions obligations. The assumptions used to arrive at the value of the pension deficit are highly judgemental. The setting of these assumptions in accordance with IAS19(R) Employment Benefits will be an area of audit emphasis. The Fund Actuary is also due to complete the next cycle of triennial valuations of the pension scheme during the 2015-2016 financial year.	We have: ► Reviewed the actuarial report and will review the fund actuary triennial valuation once this is finalised. We have tested the reasonableness of key actuarial assumptions. ► We have also used our EY pensions specialist as appropriate to support us with this work and to review the appropriateness of the IAS19 valuation methodology. ► Reviewed the disclosure of deficit and assumptions in the financial statements to ensure that it is fair, balanced and understandable.	Our planned procedures in relation to this risk is in progress. We have reviewed the actuarial reports and our Pensions specialist is in the process of concluding on the appropriateness of the IAS 19 valuation methodology applied. We are awaiting the following before we can finalise this work: ► KPMG assurance on investment fund/asset values and membership data submitted to the Actuary. KPMG are the auditors for the TfL Pension Fund. These assurances are due by mid June 2016. ► Receipt of the fund actuary triennial valuation report. We are not anticipating any issues based on our preliminary work.

Addressing audit risks

Other audit risks

We identified the following other audit risks during the planning phase of our audit, and reported these to you in our Audit Plan. Here, we set out how we have gained audit assurance over those issues.

Audit risk identified within our Audit Plan	Status of work	Assurance gained and issues arising
Other audit risks		
1. Consolidation of TTL and subsidiaries	► TfL Group accounts were initially released for audit on 16 May 2016. We received a second version on 19 May 2016, a third version on 23 May 2016 and a fourth version on 24 May 2016. ► TTL Group statutory accounts were released for audit on 24 May 2016. ► Our audit work in the lead up to consolidation was performed with the Group accounts (both TfL Group and TTL Group) in mind. We will leverage this work when performing our final group related procedures which are currently underway.	► TfL Group and TTL Group consolidation work is in progress and due for substantial completion by 27 May 2016.
2. Effectiveness of controls within the FSC and for diversified revenue streams, such as Contactless payment.	► We have performed controls testing on the payroll and vendor processes ► We have performed detailed audit work on the IT General Control environment ► We have reviewed the draft KPMG ISAE3402 and Agreed Upon Procedures report relating to their procedures performed on the CPAY/PAYG and Apportionment process and controls. At the date of this report, we expect to be able to place audit reliance on the work they have performed. ► During our IT General Controls testing, we identified a large number of instances where privileged SAP access had not formally been approved – we performed extensive additional testing to ensure that this access had not been misused.	► The control environment is operating effectively, but should be improved with regards privileged access. ► As a result of our additional procedures, we expect to be able to obtain reliance and will update the committee verbally.

Addressing audit risks

Other audit risks (continued)

Audit risk identified within our Audit Plan	Status of work	Assurance gained and issues arising
Other audit risks		
3. Implementation of changes in accounting for Transport Infrastructure Assets for 2016/17.	► Transport Infrastructure Assets (now referred to as Highways Network Assets(HNA) in the CIPFA Code of Practice) has prospective application from 2016/17 rather than retrospective application which was previously thought to be the case at the time of writing the Audit Plan. ► Initial discussions have taken place between EY and TfL officers throughout the year to discuss the implementation of HNA and the approach to assess the integrity and completeness of the HNA inventory records. This work has been deferred until the Code of Practice on the Highways Network Asset has been published by CIPFA in August 2016.	► HNA is a complex change to the CIPFA Code requirements which only affects 2016/2017. We will continue to liaise with TfL on HNA implementation in the lead up to the 2016/2017 year end.
4. Assessment of the Group boundary – Accounting for Joint Ventures and associates	► We have reviewed TfL's group boundary assessment and in particular the accounting for the Earls Court Partnership Joint Venture. ► We have reviewed TfL's board papers and note that there is potentially more downside risk than benefit associated with the deal made on Earls Court. However this is still in its infancy and should be kept under review.	► We are satisfied that TfL Group has significant influence over, but does not control the activities of Earls Court Partnership Limited, and it is therefore correct to account for this as an investment in associate under IAS 28.

5. Presentation of sensitive disclosures	► Our audit work on the draft 2015/2016 TfL and TTL Group accounts is currently underway. Specific work on those disclosures deemed sensitive include:
	  ► Related Party Transactions
	  ► Remuneration and termination payments (note, the disclosure for remuneration and termination payments was made available for audit on the 19th May 2016)
		► Our planned procedures in relation to this risk are in progress. A modest number of disclosure differences have been identified and adjusted.

Addressing audit risks

Other audit risks (continued)

Audit risk identified within our Audit Plan	Status of work	Assurance gained and issues arising
Other audit risks		
6. Changes and compliance with IFRS and CIPFA Code of Practice for Local Authority Accounting	► We received the initial draft 2015/2016 TfL Group accounts on 16 May 2016 and our work on consolidation and our technical review of the disclosures against the International Financial Reporting Standards requirements as well as the requirements of the CIPFA Code of Practice is currently underway. Aspects of disclosures outstanding as at 27 May 2016 include: ► Annual Governance Statement (still to be provided for audit)	► Our planned procedures in relation to this risk are in progress. ► Some minor disclosure errors have been amended for by management. ► Whilst our work to date has confirmed the disclosures are acceptable, we think there is potential to further simplify and to streamline the presentation of the financial statements. TfL should review the financial statements in the light of best practice drawing from: ► FTSE 100 annual accounts best practice eg strategic reports and FBU practices ► Consider benefits of integrated reporting and ► look to use the 2016/2017 CIPFA Code of Practice (which incorporates the results of the 'Telling the Story' consultation) as an opportunity to revisit financial statement disclosures.

Financial statements audit

Issues and misstatements arising from the audit

Progress of our audit

- The following areas of our work programme remain to be completed. We will provide an update of progress at the Audit and Assurance Committee meeting:
  - TfL and TTL Group consolidation (work in progress)
  - Review of TfL Group and TTL Group statements and disclosures (work in progress)
  - Review of the annual governance statement (received 2/6/16)
  - Cash and bank (HSBC bank confirmation o/s)
  - Investments, Borrowing and Derivatives (3rd party confirmations outstanding and being followed up)
  - PFI disclosures (responses to queries outstanding)
  - Movement in reserves statement (substantially complete)
  - Remuneration note (work in progress)
  - Pensions (awaiting KPMG assurances and TfL PF a/cs)
  - Completion of Manager and Partner review procedures
  - Receipt of a Letter of Representation
  - Whole of government accounts (to receive in July 2016)

- Subject to the satisfactory resolution of the above items, we propose to issue an unqualified audit report on the financial statements.

Uncorrected misstatements

- We have identified one audit difference within the draft financial statements, which management has chosen not to adjust. This audit difference is below our materiality threshold.
- We request that this uncorrected audit difference be corrected or a rationale as to why not corrected be considered and approved by the Audit and Assurance Committee and provided within the Letter or Representation.
- Appendix A to this report sets out the uncorrected audit difference.

Corrected misstatements

- Our audit to date has identified a small number of misstatements which our team have highlighted to management for amendment. None of the adjustments were above our materiality threshold and all of these have been corrected during the course of our work.
- A small number of disclosure related adjustments have also been agreed and adjusted for by management.

Financial statements audit

Issues and misstatements arising from the audit (continued)

Other matters

As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, we are required to communicate to you significant findings from the audit and other matters that are significant to your oversight of TfL's financial reporting process including the following:

- Qualitative aspects of your accounting practices; estimates and disclosures;
- Matters specifically required by other auditing standards to be communicated to those charged with governance. For example, issues about fraud, compliance with laws and regulations, external confirmations and related party transactions;
- Any significant difficulties encountered during the audit; and
- Other audit matters of governance interest.

We wish to report the following internal control matters to you arising from our financial statement audit:

- IT controls
- Oyster deposit and pre-paid balance write backs

Observations from our VFM work are included on pages 19 to 24.

Financial statements audit

Other matters

Issue	Findings
Other matters	
1. IT General Controls	Our planned audit approach assumed reliance on the IT General Control environment. As part of our audit work performed on IT General Controls, we identified the following matters ► There were a high number of instances where the use of privileged Firefighter access had not been formally approved. In addition no retrospective review of the activity has taken place. In order for us to place reliance on the IT General Control environment we have performed extensive alternative substantive procedures. At the date of this report, we are still finalising that work, but expect to be able to achieve reliance. ► There are13 IDs on the system with the ability to both develop and migrate changes to production. There is a risk that unauthorised or inappropriate changes may be developed and migrated to the production environment. We performed alternative substantive procedures in the current year, to gain the level of assurance required for the audit of the financial statements. ► There are circa 1000 SAP end users who have the ability to create and make amendments to automated SAP jobs. (e.g. payroll runs). We understand that these transactions may not be used on a routine basis or when performing administration of batch jobs. However, there is a risk that key scheduled jobs could be changed (either deliberately or by accident) using this access. We performed alternative substantive procedures in the current year, to gain the level of assurance required for the audit of the financial statements. We recommend that the use of privilege access is reviewed and restricted.
2. Oyster deposit and pre-paid balance write backs	Based on historical redemption rates of unredeemed balances, management have consistently written back 95% of all balances greater than 2 years. There is no time limit for customers to obtain refunds of unredeemed balances and the write back does not affect customer rights to such refunds. Whilst we do not disagree with the current accrual in this year's accounts, given the shift in customer behaviour towards using contactless payment, management should re-assess the assumptions for next year and at regular periods thereafter.

Financial statements audit

Internal control, written representations and whole of government accounts

Internal control

- It is the responsibility of TfL to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether TfL has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.
- We have tested the controls of TfL only to the extent necessary for us to complete our audit. We are not expressing an opinion on the overall effectiveness of internal control.

- We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in your financial statements of which you are not aware. We highlight the following considerations:
  - We have not sought to place assurance on the two way match control as it is not uniformly applied and a large volume of transactions are not subject to a match below a certain amount. This level was reviewed in the year given the number of small invoices received. Processes might be able to be changed to improve efficiency through the purchase to pay process.
  - Controls supporting initial authorisation of contractual clauses which link future commercial "above ground" structures contacts to "below ground" structural works, should be reviewed to see if they might be strengthened.
  - A number of IT General Control considerations have been noted already. Please refer to page 17 for details.

- We have yet to receive the Annual Governance Statement. Once we receive a copy of the AGS we will review it to ensure:
  - it complies with the requirements of CIPFA/SOLACE Delivering Good Governance in Local Government Framework; and
  - it is consistent with other information that we are aware of from our audit of the financial statements.

Request for written representations

- We will request a management representation letter to gain management's confirmation in relation to a number of matters. At the date of this report there are no additional specific representations required other than the standard representations.

Whole of government accounts

- Alongside our work on the financial statements, we also review and report to the National Audit Office on your Whole of Government Accounts return. The extent of our review and the nature of our report are specified by the National Audit Office.
- We aim to conclude our work in this area by the WGA deadline of the 30 September 2016 and will report any matters that arise to the Audit and Assurance Committee.

Arrangements to secure economy, efficiency and effectiveness

The Code of Audit Practice (2015) sets out our responsibility to satisfy ourselves that Transport for London has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. Proper arrangements are defined by statutory guidance issued by the National Audit Office.

Overall conclusion

- We considered your arrangements to:
  - Take informed decisions;
  - Deploy resources in a sustainable manner; and
  - Work with partners and other third parties.

- We identified one significant risk in relation to these arrangements in our audit plan dated 10 September 2015:
  - Sustainable resource deployment

- Since issuing our Audit Plan, we have elevated our work on the VFM sub-criteria ‘procuring supplies and services effectively to support the delivery of strategic priorities’ to a significant VFM risk based on the contract and financial risks TfL is currently exposed to in light of past decisions on ATC Signalling and Northern Line Extension projects as well as the Garden Bridge procurement. We considered the route causes of some of these and considered whether some previous year challenges could have recurred in the year.

- The work we have undertaken in response to these risks are summarised in the tables on pages 20 to 22 of this report. We are also concluding a separate report for the work performed by Internal Audit on the Garden Bridge procurement which will be reported separately.

- Our review of your arrangements to secure economy, efficiency and effectiveness in your use of resources is complete. We did not identify any significant weaknesses in TfL’s arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. We therefore anticipate issuing an unqualified value for money conclusion.

Arrangements to secure economy, efficiency and effectiveness (continued)

- We identified the following VFM risks during our audit. Here, we set out how we have gained audit assurance over those issues. We are only required to determine whether there are any risks that we consider significant, which the Code of Audit Practice which defines as: "*A matter is significant if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public*".

VFM risk identified	Impacts arrangements for :	Key Findings
Sustainable resource deployment – Significant risk		
1. TfL has significant financial risks in its business planning to 2020/21. TfL's operations and ongoing Investment Programmes are subject to a number of risks, particularly the exposure to economic risks associated with revenue reductions, grant reduction and financial markets disruption impacting on TfL's ability to borrow.	► Deploying resources in a sustainable manner	Through its year end capital and revenue outturn, annual budget setting, use of reserves and its medium term financial planning, TfL continues to plan well to secure sustainable resource deployment. However, along with many other public organisations, TfL is facing significant financial challenges over the next five years. TfL's external funding sources are reducing and are subject to change and uncertainty in future years. In addition, significant cumulative cost reductions of approximately £2.4 billion are planned for over the course of the next five years to 2020/21. Some of the future opportunities and challenges facing TfL include: ► government funding and grant reductions; ► planning for future assumptions on fare inflation, growth and charges; ► becoming self-funding by 2018 and the successful execution of the commercialisation agenda; ► volatility in business rate income forecasts that the GLA itself is subject to, and the impact this may have on future levels of business rates income due from GLA; and ► implications of future Mayoral Directions. These are particularly challenging aspects to budget for, adding a significant degree of uncertainty to TfL's funding position in the medium term. Bridging the substantial funding deficit of the future is also heavily dependent on the effective execution of the commercialisation programme. TfL is acutely aware of the challenges it faces and has robust and prudent plans to address such volatility and risks to its future budgets. It is continually reviewing its options to mitigate

Arrangements to secure economy, efficiency and effectiveness (continued)

VFM risk identified	Impacts arrangements for :	Key Findings
Sustainable resource deployment – Significant risk (continued)		
		the risks these forecast challenges pose to the delivery of its Strategic Priorities in future years. Comprehensive Business and Finance Reviews (BFR) were commissioned in early 2015/2016 with the aim to develop a more financially sustainable organisation and help develop more effective and efficient ways of working. We will continue to review this area during our 2016-2017 audit. Clearly the execution of these change programmes, cost reductions and the successful execution of the commercialisation programme are critical to the future self funding challenge. The element which is most dependent on factors outside of TfL's control is the commercialisation programme, which is also relatively new to TfL. We recommend continued vigilance of these projects, and development of early warning indicators where possible to alert management to future challenges in the projects.
Procuring supplies and services effectively to support the delivery of strategic priorities – Significant risk		
2. TfL routinely engages with partners and other third parties in order to deliver strategic priorities. The scale and complexity of the contracts TfL signs up to are significant, and require effective governance and oversight arrangements to minimise the risk and financial exposure to TfL.	► Work with partners and other third parties	Because of the issues observed on the contracts for Northern Line Extension and ATC signalling, where additional project costs may be incurred and a contract was retendered for a significantly larger sum, and the external coverage of the Garden Bridge Project, we elevated our work on the VFM sub-criteria 'procuring supplies and services effectively to support the delivery of strategic priorities' to a significant VFM risk. In response we did the following: ► For a selection of significant contracts awarded in year we have obtained an understanding of the procurement process leading up to the award of the contract. ► We have also reviewed how TfL exercises governance and oversight over key project areas, and how it considers and addresses the risks it is exposed to for these projects. ► Performed additional work on the Garden Bridge project

Arrangements to secure economy, efficiency and effectiveness (continued)

VFM risk identified	Impacts arrangements for :	Key Findings
Procuring supplies and services effectively to support the delivery of strategic priorities – Significant risk (continued)		
		► Considered route causes of any issues and reflected on whether any similar pressures existed in the financial year we are reporting on. Our work indicated that TfL does have appropriate arrangements for governance and oversight over its significant contracts and does not indicate that the contract issues we are aware of are pervasive across TfL's business operations. However it is clear from the work performed that TfL continues to be exposed to financial and legal risks either from past, present and potentially future decisions on contracts and procurement. For a complex organisation like TfL, this is not unusual. However with an increasing commercialisation programme and more underground and over ground development in the pipeline, robust management of these risks becomes more important. TfL should continue to strengthen its management and monitoring arrangements of significant contract and procurement projects, and work closer with business unit project leads from the onset to ensure it has a comprehensive understanding of all financial, legal and compliance risks TfL is exposed to from major projects. TfL has processes in place to investigate and learn from past experiences. TfL should ensure it applies lessons learnt from previous contract/project issues and ensure that where changes occur in future, in particular ensuring liability firmly sits with the party who has made the change rather than it resting with TfL. We support Internal Audit's reports relating to those matters. TfL recognise that there is not a coordinated and consistent approach to contract management and procurement throughout TfL and its subsidiaries and is establishing a Major Projects Delivery Unit to better draw together major projects, which would provide stronger assurance, which we agree will improve the management and execution of key contracts. Finally, we believe it might be appropriate to review a number of the finance service centre processing challenges to establish a more efficient end to end purchase to pay process as part of the procurement improvement project, for example supplier billing practices and data matching techniques.

Arrangements to secure economy, efficiency and effectiveness (continued)

Other observations – Decision making

Overall we have considered your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.

As noted on pages 20 to 22, our risk focus for 2015/2016 was on the latter two arrangements, namely deploy resources in a sustainable manner and working with partners and other third parties. However, we also considered the arrangements in place for TfL to take informed decisions as part of our overall VFM work.

Our observations show that there are increasing demands on the internal management reporting requirements for more reliable and transparent information to drive better decision making and improve performance. We note that significant time is spent on the preparation and detail of reports issued to committees and to the board. The result is a substantial number of reports which are considered and actioned at each committee/board meeting. We applaud the diligence of the reporting and its intentions for transparency.

We also recognise the organisational changes currently underway, and believe TfL may wish to use this as an opportunity to refresh, streamline and simplify the reporting arrangements going forwards to enable decision making through brevity and focus on the issues that matter for each stakeholder. It might be possible to improve transparency through this process and enable faster decision making, and improve confidence that issues that matter have been addressed.

Arrangements to secure economy, efficiency and effectiveness (continued)

Additional VFM work – Review of Internal Audit's work, reported in September 2015 on the Garden Bridge design procurement

At its meeting on 8th March 2016, the Audit and Assurance Committee requested that we undertook a review of the work undertaken by TfL's Internal Auditors on the audit of the Garden Bridge design procurement. Over recent months, questions and concerns have been raised by GLA's Oversight Committee on TfL's role and conduct in the procurement exercise, matters considered carefully by TfL's Audit and Assurance Committee. Internal Audit completed an audit of the Garden Bridge design procurement during the 2015-2016 financial year and presented their findings and recommendations in its report dated 15th September 2015.

We agreed with the Audit and Assurance Committee to complete a review of the Internal Audit methodology followed on the review of the procurement processes adopted on the Garden Bridge project. Our work to date has involved:

- Interviews with Head of Internal Audit and members of the Internal Audit team who performed the review to ascertain the processes followed and the judgements used in reaching their conclusion as reported in the final audit report as well as (where necessary) relevant members from the business that were involved in the audit review undertaken.
- A review of Internal Audit files to determine the effectiveness of the process followed. This has included a detailed review of the supporting audit working papers, from planning and scoping through to fieldwork and reporting.
- A re-performance of some steps in the audit.

Our findings and recommendations from this review will be presented in a separate report to the Audit and Assurance Committee. At the date of this report, we have substantially concluded our review and will be reporting our findings as soon as practicable. At this stage, we do not expect any findings and recommendations we make will have a significant influence on our proposed 2015-2016 Value for Money Conclusion.

Independence and audit fees

Independence

- We confirm there are no changes in our assessment of independence since our confirmation in our Audit Plan dated 10 September 2015.
- Further details on independence and objectivity are included in a separate paper presented to the 14 June 2016 Audit and Assurance Committee.
- We consider that our independence in this context is a matter that should be reviewed by both you and ourselves. It is therefore important that you consider the facts of which you are aware and come to a view. If you wish to discuss any matters concerning our independence, we will be pleased to do so at the forthcoming meeting of the Audit and Assurance Committee on 14 June 2016.
- We confirm that we have met the reporting requirements to the Audit and Assurance Committee, as 'those charged with governance' under International Standards on Auditing (UK & Ireland) 260 – Communication with those charged with governance. Our communication plan to meet these requirements were set out in our Audit Plan of 10 September 2015.

Audit fees

The table below sets out the scale fee and our final proposed audit fees.

	Proposed final fee 2015/16	Scale fee 2015/16	Variation comments
	£	£	
TfL total audit fee – Code work	155,925	155,925	See below
TTL total statutory fee	740,000	N/A	See below
Non-Audit work	4,000	-	Relates to the review of the TfL Business Expenses policy.

- We propose to make a fee variation for our review of Internal Audit's work on the Garden Bridge procurement and additional work required to conclude on VFM.
- We are in the process of finalising our estimate of the additional fees required for both TfL Corporation and TTL (which will include IT audit considerations as the largest element) and will discuss with the Chief Financial Officer and then report to the Audit and Assurance Committee the proposed variations to our audit fees.

Appendix A – uncorrected audit differences

- The following audit differences which are greater than £5.5m, have been identified during the course of our audit and warrant communicating to you.
- These items have not been corrected by management and all relate to the treatment of the interest free Network Rail loan. The accounting treatment adopted has treated this item as a balance sheet reclassification and resulted in an other receivable balance which Crossrail considers to reflect the commercial substance of the transaction. We consider that the provision of an interest free loan should have an impact on profit and loss.
- Relative to the current treatment adopted it is noted that over the loan agreement lifecycle this would have resulted in a net £nil impact on cumulative retained reserves as the originally booked fair value would all unwind over the loan term.

Item of account	Statement of Financial Position	Statement of comprehensive income and expenditure
	Debit/(Credit)	Debit/(Credit)
1. Loss on Initial Recognition – Opening Adjustment (P/L)		£10.7m
2. Loss on Initial Recognition – Current Year (P/L)		£5.7m
3. Interest Income – Current Year (P/L)		(£8.5m)
4. Other Receivable - Current (B/S)	(£6.1m)	
5. Other Receivable - Non-Current (B/S)	(£1.8m)	
Cumulative effect of uncorrected misstatement	***(£7.9m)***	***£7.9m***

Conclusion

We have considered the impact of the unrecorded audit difference on the 31 March 2016 financial statements and have concluded that they are immaterial, both individually and in aggregate, to the financial statements taken as a whole and are therefore able to sign an unqualified opinion.

Thank you

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[redacted]