Audit and Assurance Committee

Date: **7 June 2018**

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 EY during the course of their audit of the Statement of Accounts for the Transport for London Group for the year ended 31 March 2018.

1.2 Additional information is set out in the paper included on Part 2 of the agenda which contains exempt supplemental information. Subject to the decision of this Committee, this paper is exempt and is therefore not for publication to the public or press by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972 in that it contains information that is commercially sensitive and likely to prejudice TfL's commercial position.

2 Recommendation

2.1 **The Committee is asked to note the report and the supplemental information on Part 2 of the agenda.**

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
Supplemental information is included on Part 2 of the agenda.

List of Background Papers:

None

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Appendix 1`

Transport for London

Audit Result Reports
for the year ended 31 March 2018

Presented to the Audit and Assurance Committee

7 June 2018

Building a better
working world

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Transport for London
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30 May 2018

Dear Members of the Audit and Assurance Committee

We are pleased to attach our audit results report for consideration at the forthcoming meeting of the Audit and Assurance Committee. This report summarises our audit conclusions in relation to the Transport for London Group financial position and results of operations for the year ended 31 March 2018.

The Transport for London (TfL) Group and Corporation audits form part of our framework contract with Public Sector Audit Appointments Limited. We have undertaken our work in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's Code of Audit Practice, auditing standards and other professional requirements.

We are also the auditors of TfL's subsidiaries, Transport Trading Limited Group (TTL), Crossrail Limited and Victoria Coach Station Limited. TfL's subsidiaries are subject to the accounting requirements of the Companies Act 2006. We have undertaken our work in accordance with the requirements of UK auditing standards.

We are keen to ensure that our audit is aligned with the Audit and Assurance Committee's expectations. We welcome the opportunity to discuss this report with you on at the Audit and Assurance Committee on 7 June 2018.

Yours faithfully

Karl Havers
For and on behalf of Ernst & Young LLP

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1. Executive summary

Our audit is driven by our assessment of the financial statement risks facing Transport for London (TfL) as a Group. This is then overlaid by our assessment of risks in Transport Trading Limited (TTL) and individual companies within the Group and the propensity for these risks to result in an undetected error in the financial statements. This determines the scope and focus of our audit.

We are also required under the National Audit Office's Code of Audit Practice to form a conclusion on whether in all significant respects, Transport for London have proper arrangements in place to secure value for money in their use of resources. This is described as our Value for Money conclusion.

1.1 Risk based approach to audit

TfL

Financial

- Pensions accounting and impact of potential changes
- Financial shared service centre – effectiveness of control environment
- Treasury – controls and valuation of borrowing and investments
- Impact of transformation

Strategic

- Future funding, impact on credit rating and borrowing limits, including impact of external factors on markets such as Brexit
- Strategic changes impacting cash flow and asset values, e.g. commercial development, alignment with Mayor of London strategic priorities.
- Asset renewal and maintenance, e.g. new train stock and signalling
- Successful cultural change

Operational

- IT security and controls, e.g., asset registers, general ledger, procurement system and data protection.
- Revenue processes and recognition.
- Fixed asset management, classification and valuation.
- Cyber and information security incident – responding to the threat as fast as it evolves.
- Robustness of procurement and contract management processes.

Compliance

- Regulatory role – e.g. taxi licencing
- Claims resulting from failure, e.g. major events, contract delivery.
- Accuracy of claims and provisions, e.g., Compulsory Purchase Orders.
- Impact of legislative change.
- Fraud risk from management override

The risks highlighted above are consistent with those communicated in our Audit Planning document dated 11 October 2017.

1.2 Audit results and other key matters

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 2017/18 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

- In respect of the 2017/18 TfL (Transport for London) Group financial statements, based on our audit findings to date, we expect to issue an unqualified opinion on the financial statements. We note, however, that the Board approval of the financial statements will not be until 25 July 2018. As a result, we are required to continue to consider post balance sheet events up to the date of approval and we will consider whether there are any developments which impact the financial statements up to that date.
- At the time of issuing this report a number of matters remain in progress as set out in Section 5 and we will provide a verbal update to the Audit and Assurance Committee at the meeting on 7 June. We note that the draft financial statements and narrative report are still under review by management.
- We have provided comments on the narrative report in particular, which we believe still requires further drafting changes in order to present a fair and balanced picture. The 2017/18 financial year has included continued pressure on fares, the continued challenges around transforming TfL to be fit for the future, re-prioritisation of expenditure resulting in aborting certain capital projects and the challenges of bringing the Elizabeth line into operation.
- We have set out in Section 4 the key areas of audit focus, which includes the judgements and estimates, such as capital asset valuations and provisions, taken in preparing the financial statements. This includes the areas where we have debated with management the appropriate treatment of expenditure involving other parties, which has resulted in changes in presentation in the balance sheet.
- During our work we have noted some improvements in some aspects of the control environment. We have included some observations on the control environment resulting from our financial statement audit included in Appendix A.

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 set out in Section 6 of this report.
- We note that TfL continues to have a challenging future, as a result of continued reduction in grant funding, Mayoral priorities, the need to fund ongoing capital projects, deliver cost savings and deliver success in various commercialisation programmes, which will create continued pressure on liquidity.

Whole of government accounts

- We have performed our audit to date with Whole of Government (WGA) requirements in mind and we will complete the remainder of our work on the WGA following approval of the financial statements in order to meet the deadline of 31 August 2018.

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 once the work on Whole of Government Accounts is complete.

2. Extent and purpose of our work

Purpose of our work

Our audit was designed to:

- Express an opinion on the 2017/18 TfL Corporation, TfL Group and TTL Group financial statements and the consistency of other information published with them. This includes full scope statutory opinion audits of TfL and TTL Group's, Crossrail's and Victoria Coach Station's financial statements and disclosure notes;
- 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); and
- 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.

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.

Updated Materiality

In our audit plan we communicated our preliminary planning materiality as £109.3 million, which was based on the 2017/18 budgeted results. We have updated our planning materiality, based on the 2017/18 actual results.

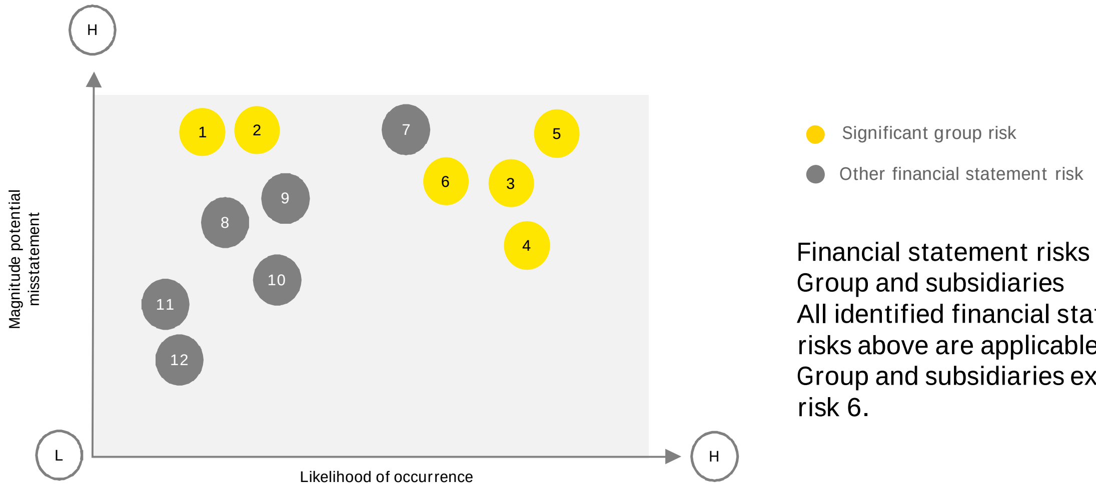
2017/18 results	Group £'million	Group £'million	Planning Materiality £'million
Total gross expenditure – capital and revenue	10,608	1.0%	106.08

This has not made a significant change to the scope of our work or the procedures we have performed.

3. Significant financial statement and VfM risks

Of the financial statement risks identified, we consider some of them to be significant to our Group audit. Auditing standards define significant risks as those with a high likelihood of occurrence and, if they were to occur, could result in a material misstatement of the consolidated financial statements, as set out graphically below. Once identified we are required by Auditing Standards to perform specific procedures over significant risks, including the identification of key controls designed to address the risks, and where appropriate testing of the effectiveness of these controls.

Financial statement risk assessment (update)
Below highlights the change in our initial financial statement risk assessment and our findings are set out in Section 4.



Financial statement risks for TTL Group and subsidiaries
All identified financial statement risks above are applicable to the TTL Group and subsidiaries except for risk 6.

Financial statement risks	Year end update
1. Management override of controls, required by ISA (UK and Ireland) 240	No change
2. Inappropriate Revenue Recognition , required by ISA (UK and Ireland) 240	The significant risk only relates to the Fares revenue.
3. Inappropriate capitalisation or potential impairment of capital projects	No change in risk, we did extend our testing of capitalisation in respect of projects involving other parties see later in this section
4. Significant accounting estimates, including complexity of provisions and accruals	No change
5. Complexity of accounting for TfL's property portfolio	No change
6. Judgemental assumptions impacting on TfL's pension deficit	No change
7. Complexity of accounting and disclosures for TfL's borrowing and treasury management	No change
8. Consolidation of TTL and subsidiaries	No change
9. Effectiveness of controls within the FSC and for diversified revenue streams, such as Contactless payment.	No change
10. Assessment of the Group boundary – Accounting for Joint Ventures and associates	No change
11. Application of new accounting standards e.g. IFRS 15, IFRS 9 and IFRS 16	Disclosure made in current year, impact on accounting within the financial statements is a future year risk
12. Presentation of sensitive disclosures	No change
13. Regulatory challenge and disputes – e.g., taxi licensing	No change

4. Audit risks and execution

4.1 Significant Risks

We identified the following significant audit risks during the planning phase of our audit and reported these to you in our Audit Plan. We set out below a summary of the audit procedures performed to gain audit assurance over these risks and our conclusions reached.

Area of emphasis	Summary of audit performed
Management override of controls, required by ISA (UK and Ireland) 240 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 both TfL, 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; and ► Understood the oversight given by those charged with governance of management's processes over fraud. *There were no material matters arising from our work.*
Inappropriate Revenue Recognition, required by ISA (UK and Ireland) 240 TfL need to have robust controls in place to forecast and accurately recognise and report revenue in its financial statements. Based on our audit experience, we have concluded that there is limited risk of material misstatement in the recognition of non-fare income and therefore we no longer consider this to be a fraud risk for our audit. Our procedures have therefore focused on the recognition of fare income which comprises £4.4billion (2017/18) generated through various sources including cash and contactless payments which is apportioned with the Train Operation Companies "TOC" and recognised over the life od the product.	For Fares Revenue, we have performed the following audit procedures: ► Gained an understanding of the revenue process for fares revenue; ► Performed controls testing over the effectiveness of the cash collection process and sales made at various sales outlets; ► Tested to ensure that the OCM offset payment which has been recorded for the current year is appropriate. ► Tested to ensure that the Receipts in Advance "RIA" and JFT Debtor balance is correctly stated; ► Tested the appropriateness of assumptions used by management on the oyster write-back policy adopted; ► Tested transactions separately where we are not able to place reliance over the controls in place or where procedures above are not sufficient.

4.1 Significant Risks (continued)

Area of emphasis	Summary of audit procedures
Inappropriate Revenue Recognition, required by ISA (UK and Ireland) 240 (continued)	*Our planned procedures in relation to this risk are complete, except for KPMG's testing of controls over contactless ticketing and Oyster pay as you go, set out in their ISAE3402 report and agreed procedures report. This is currently outstanding and we are planning to rely on it.* *We note that in respect of the fare compensation with the TOCs are the subject of ongoing discussion with the TOCs. We are satisfied that the position recorded within the financial statements relating to the potential revenue due to the TOCs is within an acceptable range, using the latest available information in respect of the discussions.* *There were no other matters arising from our revenue testing.*
Inappropriate capitalisation or potential impairment of capital projects TfL, TTL and subsidiaries undertake multiple capital projects at any one time which vary in size, complexity and length of time to complete. In 2017/18 financial year, TfL's capital expenditure was £3.54 billion. 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; and • Whether to recognise impairments and write-offs for assets to reflect either increased risks of projects being terminated or suspended.	For TfL, TTL groups and subsidiaries we have: ► Reviewed 35 major projects (including Crossrail) based on quantitative and qualitative thresholds, see further information on the next page; ► Understood key controls and governance surrounding capital project accounting and management; ► Met with management and project managers during the year and attended management's P11 and P13 capital accruals meetings; ► Evaluated management's judgements and assumptions used in determining the future benefits expected from the projects and ensuring they are appropriate and supportable; ► Considered pain/gain arrangements and related accounting treatment. Assessed whether or not capitalisation of costs is appropriate as per internal pain/gain accounting policy implemented in current year; ► Considered assets impairment and reviewed written off costs during the year on major projects; ► Performed detailed testing on a sample of expenditure incurred and capital accruals to source documentation; and ► Considered application of accounting treatments on percentage of completion basis with contract payments on milestone basis. *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 that the capitalised costs in the year is appropriate. We have set out on the following page some of the areas of complexity debated with management during our work.*

4.1 Significant Risks (continued)

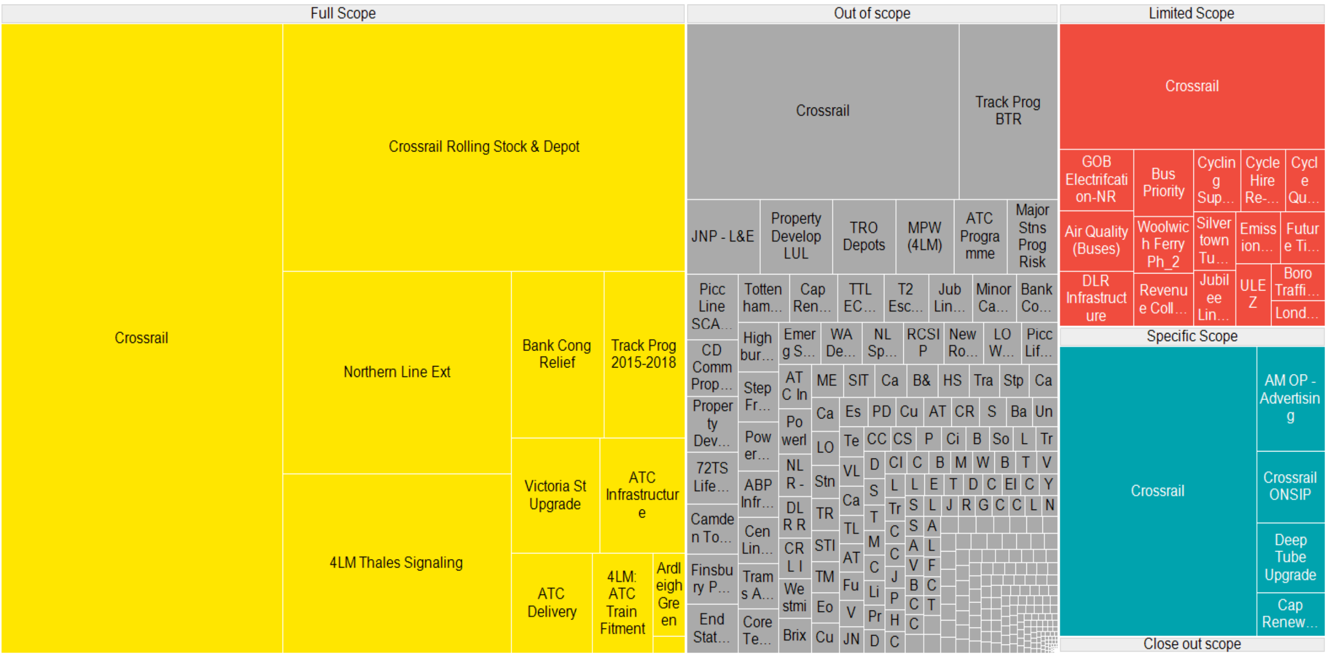
Area of emphasis	Summary of audit procedures
Inappropriate capitalisation or potential impairment of capital projects (continued)	*Our testing identified a number of cases, where the project involved various third parties such as:* ø *Project to electrify certain portions of Network Rail track* ø *Project to reduce emissions of certain types of buses owned by third party bus operators* ø *Projects in respect of cycling networks involving the London Boroughs* *The above projects are complex in terms of understanding the nature of the expenditure incurred, the resulting asset and the control of such assets post completion of the project. The understanding of the contractual and legal rights of TfL in respect of such contracts can be complex, but are critical in determining the accounting for such expenditure and whether it qualifies for presentation as a fixed asset, a contract asset or a grant.* *We have challenged management on these matters and understood the relevant legislation setting out TfL's ability to control future use of such assets, requirements to meet future maintenance obligations and the ability of TfL to take enforcement action.* *We have reported separately to the Audit and Assurance Committee on this matter. Our work on the electrification of Network Rail track is in progress at the time of writing this report. Aside from completion of this point, we are satisfied that there are no material misstatements in financial statements.* *We also considered the matters identified in our 2016/17 in respect of accounting for milestone payments and did not identify any similar matters in the current year.* *We have further discussed the risk of impairment on the following page.*

4.1 Significant Risks (continued)

Capitalised expenditure incurred in the year

As set out in our Audit Plan, we have tested a sample of capital projects. The project sample selection process included stratifying the contracts between full, specific, limited and close out scope based on certain risk factors including target disputes, claims and percentage completion. For all contracts identified as full and specific scope, we have obtained a detailed contract questionnaire and challenged management's assumptions. For full scope contracts this included holding face-to-face contract meetings with the project management teams and site visits. For all limited and close out scope contracts we have agreed spend in the year to the latest contractor certificates and considered the reasonableness of the forecast costs to complete.

As part of our audit procedures, we have performed detailed contract testing covering 72% of the capitalised expenditure incurred during the year. The diagram below shows a box for each active project in the year with the size of the box corresponding to the value of the capitalised spend during in year. The contracts selected for testing during the year are categorised below into their designated scoping.



In progress capital projects

From a Group perspective the largest in progress capital project is Crossrail which is nearing completion and due to open for operation at the end of 2018. We have completed a statutory audit of Crossrail as a subsidiary of TfL. The close down of contracts over 2018/19 and later is likely to result in further claims from contractors and subcontractors, particularly if deadlines are squeezed to meet the opening date. This does give rise to the risk of additional costs and pressures on funding for TfL as an organisation which will require careful management.

At the balance sheet date, TfL also has a number of other significant capital projects at various stages of completion. We have challenged management as to whether there are any significant changes in plans (around aborted projects or projects put on hold) which would indicate any impairment. We note management has recognised an impairment of costs previously incurred on two projects, where plans have changed and the projects are no longer included in the current business plan and within available funding. We will seek confirmation in the letter of representation that the remaining expenditure carried forward in the balance sheet for in progress projects are expected to be funded and that there is no impairment required in the carrying value at 31 March 2018.

4.1 Significant Risks (continued)

Area of emphasis	Summary of audit procedures
Significant accounting estimates, including complexity of provisions and accruals 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 come from its capital investment activities. In particular CPO provisions and contractual disputes are subject to significant estimation and include uncertainty around negotiations.	For TfL, TTL groups and subsidiaries we have: ► Tested material provisions and accruals for business purpose and appropriateness of estimation techniques. ► Calculated the sensitivity of the provisions to changes in assumptions 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. *TfL is in the process of implementing a transformation programme. The goal being to reduce inefficiencies, by creating a streamlined and cost effective organisation that is self sufficient. The transformation programme is ongoing at 31 March 2018 and therefore severance provisions totalling £51.0 million have been recognised at 31 March 2018. The provision has been recognised in accordance with accounting standards, where the position is sufficiently clear and communication with the affected individuals has been held.* *Other provisions recognised at the balance sheet date include compensation and contractual matters, compulsory purchase orders re capital investment activities and environmental harm provisions. These are subject to estimation techniques as a result of uncertainty in respect of completion of negotiations and the timing and level of settlement. We have tested supporting evidence. There were no material matters identified. We are satisfied that the provisions made are within an acceptable range, based on latest available information.* *There were no other matters to report.*

4.1 Significant Risks (continued)

Area of emphasis	Summary of audit procedures
Complexity of accounting for TfL's property portfolio TfL and TTL groups have an extensive property portfolio, with a total book value of assets held at valuation is £842 million as at 31 March 2018. Included within the portfolio are infrastructure assets, office buildings, investment properties. 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, TTL group 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 external valuers 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 arise during 2017/18. • Assessed the work of TfL's property valuers. Our EY property valuation team supported our review and testing of the accounting entries and disclosures made in the financial statements. • Reviewed Infrastructure and office buildings, PFI accounting models and appropriateness of accounting and disclosures. • Considered the classification of assets between investment properties, property, plant and equipment and assets held for sale in accordance with IFRS. *Based on the work performed, we have concluded that the property valuations are within an acceptable range.* *There has been an acquisition of new entity in March 2018, mainly consisting of investment property in Southwark. This was reviewed in addition to the sample selected. The valuation for this property was found by our internal valuation team to be within an acceptable range.* *We have reviewed the properties classifications and have concluded that they are appropriate disclosed in the financial statements.*
Investment in associate – Kidbrooke In 2017/18 the Group entered into an arrangement to deliver the redevelopment of land owned by TfL in Kidbrooke. The Group holds a 49% share in Kidbrooke LLP, the partnership established to deliver the development.	Our approach has been to: ► Obtain the JV contract to understand the agreement between the involved parties to the JV; and ► To review the accounting treatment. *We have completed our procedures and no material issues were identified.*

4.2 Other audit risks (continued)

The following matters are in progress at the time of writing this report

Other area of emphasis	Summary of audit procedures
Judgemental assumptions impacting on TfL's pension deficit At the 31 March 2017, TfL's defined pension schemes had a deficit of £5.4 billion. The TfL Group balance sheet includes the deficit on the TfL Pension Fund and 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.	At the time of writing this report we are still awaiting reports from the actuaries on assumptions and from KPMG in respect of asset values. Once these reports re received our work will include: • Reviewing the actuarial report and fund actuary triennial valuation. Testing the reasonableness of key actuarial assumptions. • Assessing the information from KPMG in terms of their audit of investment fund/asset values and membership data submitted to the actuary (KPMG are the auditors of the TfL Pension Fund) • Using our EY pensions specialist as appropriate to support us with this work and to review the appropriateness of the IAS19 valuation methodology. • Reviewing the disclosure of deficit and assumptions in the financial statements to ensure that it is fair, balanced and understandable.
Presentation of sensitive disclosures Our audit work on the draft 2017/18 TfL and TTL Group accounts is currently underway. Specific work on those disclosures deemed sensitive include: ► Related Party Transactions; and ► Remuneration and termination payments.	Our approach is to: ► Test disclosures to underlying records; and ► Compare of the disclosures made to best practice such as adopted by the FTSE100. *At the time of issuing this report our work is in progress, we have not identified any issues to date.*
Investment in associate – Earls Court The Group holds a 37% share in Earls Court Partnership Limited (ECP) and accounts for its share of the income statement result and assets and liabilities in the Group financial statements. In the year the Group's share of the value in ECP has reduced by £61 million, representing the significant adjustment in ECP to the carrying value of the land (c£170m reduction in land value). This has arisen due to issues with planning.	Our approach has been to: ► Obtain latest financial information for ECP and test the accounting to supporting documentation. *There were no issues to note with the accounting adopted, however we note that progress on this project needs careful monitoring to ensure further future losses can be mitigated.*

5. Financial statements audit

5.1 Progress of the 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:

- Certain bank confirmations;
- Pensions – actuarial reports and KPMG's audit report of investment fund/asset values and membership data;
- Fares revenue –KPMG's ISAE3402 and Agreed Upon Procedures report over contactless ticketing and Oyster pay as you go;
- Post balance sheet events up to the date of approval of the financial statements;
- Receipt of signed letter of representation.

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

5.2 Misstatements

We not identified any misstatements that are individually or in aggregate material to the presentation and disclosures of the consolidated financial statements for the year ended 31 March 2018. We note that the unadjusted difference identified in our 2016/17 audit, being a severance provision of £5.6m that had not met the criteria for recognition has 'turned around' in the 2017/18 financial statements and we concur with the closing severance provision.

During our audit work, management has corrected the presentation of certain assets in the balance sheet, resulting in the classification of £12.6m of assets from fixed assets into contract assets.

5.3 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.

Internal control

It is the responsibility of management to establish and maintain proper implementation of internal control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as auditor is to consider whether management has put adequate arrangements in place to satisfy itself that the systems of internal controls has adequate design and operating effectively.

We have tested the controls of TfL only to the extent necessary for us to get a reasonable assurance over the controls. Although our audit was not designed to express an opinion on the effectiveness of internal control we are required to communicate significant deficiencies in 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 TfL's financial statements of which the management is aware.

We have highlighted a number of recommendations for internal control to management. Our observations include improving controls surrounding improvements in the capital projects process, oversight of third parties providing services related to congestion charging, IT access controls and inventory. We have set out further detail in Appendix A.

Annual Governance Statement

Our responsibility is to review the Annual Governance Statement 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.

We have completed our procedures and there are no matters to arising from our review.

Request for written representations

We will request a management representation letter to gain management's confirmation in relation to a number of matters.

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 31 August 2018 and will report any matters that arise to the Audit and Assurance Committee.

6. 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 11 October 2017:

- Sustainable resource deployment

The work we have undertaken in response to these risks are summarised in the table below.

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.

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	Key Findings
Sustainable resource deployment – Significant risk	
1. TfL has significant financial risks in its Business Plan to 2020/21 and we note that a revised Business Plan will be published in December covering the period to 2021/22. TfL's external funding sources are reducing and are subject to change and uncertainty in future years. In addition, significant cumulative cost reductions are planned for over the course of the next five years to 2020/21.	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. Passenger income for the year was 3% below budget, this was driven by lower than anticipated journeys on London Underground and Rail services. Buses passenger numbers were higher than forecast, reflecting the improvement in bus speeds in comparison to the prior year. Lower revenue has been mitigated through additional reductions in operating costs, with the net operating surplus for 2017/18 being £26m above budget. The 2018/19 budgeting process is soundly based, with a detailed economic model supporting passenger and revenue forecasts. Arrangements underpinning the 2018/19 budget are considered good, with TfL leveraging the work being performed elsewhere as part of the cost reduction programme. The forecast operating surplus for 2018/19 included in the budget is consistent with business plan published in December at £12m, with minor adjustments in the forecasts for revenue and operating costs reflecting updated forecasts. This will be the first year where TfL receives no revenue grants from central government. Planned passenger and revenue growth are at the pessimistic range of forecasts, reflecting the uncertainties in the wider economy which impact on discretionary journeys. We note that TfL continues to have a challenging future, as a result of continued reduction in grant funding, Mayoral priorities, the need to fund ongoing capital projects, deliver cost savings and deliver success in various commercialisation programmes, which will create continued pressure on liquidity.

VFM risk identified	Key Findings
TfL's operations and ongoing Investment Programmes are subject to a number of risks, particularly the exposure to economic risks associated with revenue reductions, and financial markets disruption impacting on TfL's ability to borrow.	Some of the future challenges facing TfL include: ► government funding and grant reductions, revenue grant funding reducing to nil in 2018/19; ► planning for future assumptions on fare inflation, growth and charges; ► 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 ► impact on capital projects of changes in policy and funding. These are particularly challenging aspects to budget for, adding a significant degree of uncertainty to TFL's funding position in the medium term. Achieving the target of a net surplus on operations after financing cost by 2021/22, will be a significant challenge, one that dependent on the effective execution of the commercialisation programme and the continued cost reduction programme. External borrowing is a key source of TFL's financing for future capital projects, and therefore it is crucial that financial performance metrics such as EBITDA are the focus for business, to reassure lenders of TFL's ongoing stability.

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 above our risk focus for 2017/18 was on how TfL deploys resources in a sustainable manner. However, we also considered the arrangements in place for TfL to take informed decisions and work with partners and other third parties as part of our overall VFM work, we have no other observations to report.

Appendix A – Internal control observations

We have shared with management observations arising during our audit testing, these are summarised below.

Obs. #	Area of review	Recommendation
1	Capital Projects –Accounting treatments documentation	Formal documentation and approval of accounting treatments
2	Capital projects – Cycling Quietways and Superhighways	Implementation of a formal process of inspection of Borough compliance with maintenance obligations
3	Congestion charging – Capita service organisation	Exercise powers under service agreement to gain assurance over processes and controls in place at Capita, including quarterly monitoring and potential service auditor reporting
4	Manage Access – DEBUG access	Timely review of business need for users access
5	Manage Access – Leavers untimely termination	Timely removal of leavers access to systems
6	Manage Access – User access review	Periodic review of user access should be performed for SAP users
7	Inventory – SAP Bar codes	Full utilisation of barcode system
8	Inventory – Inventory held at third party	Improve location tracking of stock
9	Inventory – Location record	Improve location tracking of stock
10	Inventory – Differences noted	Timely update of records

Appendix B – Required communications with the Audit and Assurance Committee

There are certain communications that we must provide to the Audit Committees of UK clients. We have detailed these here together with a reference of where and when they were covered:

Planned/actual timing of communication to the Audit Committee	
Planning and audit approach Communication of the planned scope and timing of the audit including any limitations.	Discussed within our Audit Planning Report

Significant findings from the audit
 	
► Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures
► Significant difficulties, if any, encountered during the audit
► Significant matters, if any, arising from the audit that were discussed with management
► Written representations that we are seeking
► Expected modifications to the audit report
► Other matters if any, significant to the oversight of the financial reporting process
► Unless covered by other communications on planning matters or significant findings, this information shall include views on:
► Business risks relevant to financial reporting objectives, the application of materiality and the implications of our judgments in relation to these for the overall audit strategy, the audit plan and the evaluation of misstatements identified.
► The significant accounting policies (both individually and in aggregate);
► Management's valuations of the entity's material assets and liabilities and the related disclosures provided by management;
► Internal control*, specifically on:
  ► The effectiveness of the entity's system of internal control over financial reporting; and
  ► Other risks arising from the entity's business model and the effectiveness of related internal controls,
► Any other matters identified in the course of the audit that we believe will be relevant to the board or the audit committee in the context of fulfilling their responsibilities referred to above.
	Discussed within this report

Appendix B – Required communications with the Audit and Assurance Committee (continued)

Planned/actual timing of communication to the Audit Committee	
Misstatements ► Uncorrected misstatements and their effect on our audit opinion ► The effect of uncorrected misstatements related to prior periods ► A request that any uncorrected misstatement be corrected ► In writing, corrected misstatements that are significant	No issues to report
Fraud ► Enquiries of the audit committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity ► Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ► A discussion of any other matters related to fraud	No issues to report
Related parties Significant matters arising during the audit in connection with the entity's related parties including, when applicable: ► Non-disclosure by management ► Inappropriate authorisation and approval of transactions ► Disagreement over disclosures ► Non-compliance with laws and regulations ► Difficulty in identifying the party that ultimately controls the entity	Discussed within this report - no issues to report
External confirmations ► Management's refusal for us to request confirmations ► Inability to obtain relevant and reliable audit evidence from other procedures	No issues to report
Consideration of laws and regulations ► Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off ► Enquiry of the audit committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the audit committee may be aware of	No issues to report

Appendix B – Required communications with the Audit and Assurance Committee (continued)

Planned/actual timing of communication to the Audit Committee	
Independence Communication of all significant facts and matters that bear on EY's objectivity and independence Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as: ► The principal threats ► Safeguards adopted and their effectiveness ► An overall assessment of threats and safeguards ► Information about the general policies and process within the firm to maintain objectivity and independence For listed companies, communication of minimum requirements as detailed in the ethical standards: ► Relationships between EY, the company and senior management ► Services provided by EY that may reasonably bear on the auditors' objectivity and independence ► Related safeguards ► Fees charged by EY analysed into appropriate categories such as statutory audit fees, tax advisory fees, other non-audit service fees ► A statement of compliance with the ethical standards ► The audit committee should also be provided an opportunity to discuss matters affecting auditor independence	Discussed within our separate letter for the meeting on 7 June 2018
Going concern Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: ► Whether the events or conditions constitute a material uncertainty ► Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ► The adequacy of related disclosures in the financial statements	Discussed within this report – see Section 6
Significant deficiencies in internal controls identified during the audit	No material deficiencies – control observations are included in this report

Appendix B – Required communications with the Audit and Assurance Committee (continued)

Planned/actual timing of communication to the Audit Committee	
Group audits ► An overview of the type of work to be performed on the financial information of the components ► An overview of the nature of the group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components ► Instances where the group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work ► Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted ► Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements	Discussed within our Audit Planning Report - there are no further matters to report.

Appendix C – Draft Letter of representation

This letter of representations is provided in connection with your audit of the consolidated and the Corporation financial statements of Transport for London Group (“the Group”) and Transport for London (“the Corporation”) for the year ended 31 March 2018. I recognise that obtaining representations from me concerning the information contained in this letter is a significant procedure in enabling you to form an opinion as to whether the consolidated and parent financial statements give a true and fair view of the Group and Corporation financial position of Transport for London as of 31 March 2018 and of its financial performance and its cash flows for the year then ended in accordance with CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.

I understand that the purpose of your audit of the consolidated and corporation financial statements is to express an opinion thereon and that your audit was conducted in accordance with International Standards on Auditing (UK & Ireland), which involves an examination of the accounting system, internal control and related data to the extent you considered necessary in the circumstances, and is not designed to identify - nor necessarily be expected to disclose - all fraud, shortages, errors and other irregularities, should any exist.
Accordingly, I make the following representations, which are true to the best of my knowledge and belief, having made such inquiries as I considered necessary for the purpose of appropriately informing myself:

A. Financial Statements and Financial Records

1. I have fulfilled my responsibilities, under the relevant statutory authorities, for the preparation of the financial statements in accordance with the Accounts and Audit Regulations 2015 and CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.

2. I acknowledge, as Statutory Chief Finance Officer, my responsibility for the fair presentation of the consolidated and the Corporation financial statements. I believe the consolidated and the Corporation financial statements referred to above give a true and fair view of the financial position, financial performance (or results of operations) and cash flows in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 and are free of material misstatements, including omissions. The TfL Board has approved the consolidated and the Corporation financial statements.

3. The significant accounting policies adopted in the preparation of the Group and the Corporation financial statements are appropriately described in the Group and the Corporation financial statements.
4. I believe that the Group and the Corporation have a system of internal controls adequate to enable the preparation of accurate financial statements in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 that are free from material misstatement, whether due to fraud or error.
5. I believe that the effects of any unadjusted audit differences, summarised in the accompanying schedule, accumulated by you during the current audit and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the consolidated and/or Corporation financial statements taken as a whole.

B. Non-compliance with law and regulations, including fraud

1. I acknowledge that I am responsible to determine that the Group and Corporation’s activities are conducted in accordance with laws and regulations and that we are responsible to identify and address any non-compliance with applicable laws and regulations, including fraud.
2. I acknowledge that I am responsible for the design, implementation and maintenance of internal controls to prevent and detect fraud.
3. I have disclosed to you the results of my assessment of the risk that the consolidated and the Corporation financial statements may be materially misstated as a result of fraud.

Appendix C – Draft Letter of representation (continued)

4. I have disclosed to you all significant facts relating to any frauds, suspected frauds or allegations of fraud known to me that may have affected the Group or the Corporation (regardless of the source or form and including, without limitation, allegations by “whistle-blowers”), whether involving management or employees who have significant roles in internal control. Similarly, I have disclosed to you my knowledge of frauds or suspected frauds affecting the entity involving others where the fraud could have a material effect on the consolidated or the Corporation financial statements. I have also disclosed to you all information in relation to any allegations of fraud or suspected fraud communicated by employees, former employees, analysts, regulators or others, that could affect the Group or the Corporation financial statements.

5. C. Information Provided and Completeness of Information and Transactions
1. I have provided you with:
    - Access to all information of which I am aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
    - Additional information that you have requested from me for the purpose of the audit; and
    - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
2. All material transactions have been recorded in the accounting records and are reflected in the consolidated and the Corporation financial statements.
3. I have made available to you all minutes of the meetings of the Corporation, and committees (or summaries of actions of recent meetings for which minutes have not yet been prepared) held through the year to the most recent meeting as shown online on the Transport for London website.
4. I confirm the completeness of information provided regarding the identification of related parties. I have disclosed to you the identity of the Group and the Corporation’s related parties and all related party relationships and transactions of which I am aware, including sales, purchases, loans, transfers of assets, liabilities and services, leasing arrangements, guarantees, non-monetary transactions and transactions for no consideration for the year ended, as well as related balances due to or from such parties at the year end. These transactions have been appropriately accounted for and disclosed in the consolidated and the Corporation financial statements.
5. I believe that the significant assumptions I used in making accounting estimates, including those measured at fair value, are reasonable.
6. I have disclosed to you, and the Group and the Corporation has complied with, all aspects of contractual agreements that could have a material effect on the consolidated and the Corporation financial statements in the event of non-compliance, including all covenants, conditions or other requirements of all outstanding debt.

D. Liabilities and Contingencies
1. All liabilities and contingencies, including those associated with guarantees, whether written or oral, have been disclosed to you and are appropriately reflected in the consolidated and the Corporation financial statements.
2. I have informed you of all outstanding and possible litigation and claims, whether or not they have been discussed with legal counsel.
3. I have recorded and/or disclosed, as appropriate, all liabilities related litigation and claims, both actual and contingent.

E. Subsequent Events
1. There have been no events subsequent to year end which require adjustment of or disclosure in the consolidated and the Corporation financial statements or notes thereto.

F. Group audits
1. Necessary adjustments have been made to eliminate all material intra-group unrealised profits on transactions amongst parent, subsidiary undertakings and associated undertakings.

Appendix C – Draft Letter of representation (continued)

G. Use of the Work of a Specialist

1. I agree with the findings of the specialists that we engaged to evaluate the assumptions for actuarial assessment of the pension scheme and the valuation of certain land and buildings and have adequately considered the qualifications of the specialists in determining the amounts and disclosures included in the consolidated and Corporation financial statements and the underlying accounting records. We did not give or cause any instructions to be given to the specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an effect on the independence or objectivity of the specialists.

H. Accounting Estimates

1. I believe that the measurement processes, including related assumptions and models, used to determine the accounting estimates have been consistently applied and are appropriate in the context of the applicable financial reporting framework.
2. I confirm that the significant assumptions used in making the accounting estimate appropriately reflect my intent and ability to carry out on behalf of the entity.
3. I confirm that the disclosures made in the consolidated and the Corporation financial statements with respect to the accounting estimates are complete and made in accordance with the applicable financial reporting framework.
4. I confirm that no adjustments are required to the accounting estimates and disclosures in the consolidated and the Corporation financial statements due to subsequent events.

I. Retirement benefits

1. On the basis of the process established by me and having made appropriate enquiries, I am satisfied that the actuarial assumptions underlying the scheme liabilities are consistent with my knowledge of the business. All significant retirement benefits and all settlements and curtailments have been identified and properly accounted for.

J. Other information

1. I acknowledge my responsibility for the preparation of the other information.
2. I confirm that the content contained within the other information is consistent with the financial statements.

K. Capitalisation of costs

1. I have considered the costs capitalised relating to incomplete projects that are in progress at the balance sheet date. I have considered the current status of these projects, in the context of available funding, current business plans, Mayoral and Department for Transport policies. Having considered these matters, there are no projects, for which we have capitalised costs in the balance sheet at 31 March 2018, which we do not believe will proceed to completion. We also have not identified any abortive costs and are not aware of any reason why the value of such projects carried forward should be impaired in accordance with applicable accounting standards.
2. I have considered the cost capitalised relating to projects that cover both Transport for London Road Network and London Borough roads, and believe that the Corporation has sufficient control to appropriately recognise these costs as an asset under IAS16. In addition the Corporation will further strengthen the control over these assets through implementing a regular programme of inspection of these assets, to obtain assurance that the assets are being appropriately maintained.

This letter was discussed at the Audit and Assurance Committee on 7 June 2018 and was subsequently agreed by Chair's action.

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Ernst & Young LLP