

Audit and Assurance Committee

Date: 11 October 2016

Item: Annual Audit Letter

This paper will be considered in public

1 Summary

- 1.1 To inform the Audit and Assurance of the status of Annual Audit Letter to be issued by Ernst and Young (EY).

2 Recommendation

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

3 Background

- 3.1 The Annual Audit Letter is prepared by EY and summarises their conclusions on the Annual Statement of Accounts and Value for Money. This letter is issued at the conclusion of the annual audit process and following certification of the Whole of Government Accounts return in late September/early October each year.

4 Update

- 4.1 EY issued unqualified opinions on the TfL financial statements, including the value for money conclusion, and on the Whole of Government Accounts return.
- 4.2 EY certified the Whole of Government Accounts return on 27 September and this has now been submitted to HM Treasury.

List of appendices to this report:

Appendix 1: EY's Annual Audit letter 2015/16

List of Background Papers:

None

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Transport for London

Annual Audit Letter for the year ended 31 March 2016

3 October 2016

Ernst & Young LLP

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In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued ‘Statement of responsibilities of auditors and audited bodies 2015-16’. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The ‘Terms of Appointment from 1 April 2015’ issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Directors/Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

A hand with white nail polish is writing on a document with a blue pen. In the background, there is a calculator, a laptop, and a white mug. A yellow rectangular box is overlaid on the left side of the image.

Executive Summary

Executive Summary

The National Audit Office's Code of Audit Practice requires auditors to prepare an annual audit letter and issue it to Transport for London following completion of our audit procedures for the year ended 31 March 2016. This Annual Audit Letter ('the letter') summarises the key issues arising from our 2015/16 audit at Transport for London ('TfL'). Although this letter is addressed to the Board members of TfL, it is also intended to communicate key issues to external stakeholders, including members of the public. The letter will also be published on the PSAA website at www.psa.co.uk. It is the responsibility of TfL to publish the letter on the TfL website at www.tfl.gov.uk.

We have already reported the majority of points discussed in this letter to you, our detailed findings were reported to the 14 June 2016 Audit and Assurance Committee. Since that date we completed our the outstanding procedures in order to issue our audit report.

We audited the Transport for London's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 28 July 2016.

Since the issue of our audit report, we have also completed our procedures on the accuracy of the consolidation pack the corporation needs to prepare for the Whole of Government Accounts, no issues were found with this work.

Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on Transport for London's: ▶ Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Group and Corporation as at 31 March 2016 and of the Group's and Corporation's expenditure and income for the year then ended
▶ Consistency of the Annual Report and other information published with the financial statements	Financial information in the Annual report and published with the financial statements was consistent with the Annual Accounts

Area of Work	Conclusion
<p>Reports by exception:</p> <ul style="list-style-type: none"> ▶ Consistency of Governance Statement 	The Governance Statement was consistent with our understanding of Transport for London
<ul style="list-style-type: none"> ▶ Public interest report 	We had no matters to report in the public interest
<ul style="list-style-type: none"> ▶ Value for money conclusion 	We had no matters to report

Area of Work	Conclusion
Report to the National Audit Office (NAO) on the accuracy of the consolidation pack the corporation needs to prepare for the Whole of Government Accounts	We reported to the National Audit Office on 27 September 2016, there were no findings from this work.

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of Transport for London communicating significant findings resulting from our audit.	Our Audit results report was issued on 27 May 2016
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 27 September 2016

We would like to take this opportunity to thank Transport for London staff for their assistance during the course of our work.



Karl Havers
 Partner
 For and on behalf of Ernst & Young LLP



Purpose

Purpose

The Purpose of this Letter

The purpose of this annual audit letter is to communicate to members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of Transport for London.

We have already reported the detailed findings from our audit work in our 2015/16 annual results report to the 14 June 2016 Audit and Assurance Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Corporation.

Responsibilities

Responsibilities

Responsibilities of the Appointed Auditor

Our 2015/16 audit work has been undertaken in accordance with the Audit Plan that we issued on 8 October 2015 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

Expressing an opinion:

- ▶ On the 2015/16 financial statements;
- ▶ On the consistency of other information published with the financial statements, including the annual report.

Reporting by exception:

- ▶ If the annual governance statement does not comply with relevant guidance or is not consistent with our understanding of Transport for London;
- ▶ Any significant matters that are in the public interest.
- ▶ Forming a conclusion on the arrangements Transport for London has in place to secure economy, efficiency and effectiveness in its use of resources.

Responsibilities of Transport for London

Transport for London is responsible for preparing and publishing its statement of accounts, annual report and annual governance statement. It is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Financial Statement Audit

Financial Statement Audit

Key Issues

The Annual Report and Accounts is an important tool for Transport for London to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Transport for London's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 28 July 2016.

Our detailed findings were reported to the 14 June 2016 Audit and Assurance Committee. The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
Management override of controls	We have not identified any material weaknesses in controls or evidence of material management override. We have not identified any instances of inappropriate judgements being applied.
Revenue and expenditure recognition	Our testing has not revealed any material misstatements with respect to revenue and expenditure recognition.
Inappropriate capitalisation or potential impairment of capital projects	Our testing has not revealed any material misstatements in respect of capitalised expenditure and the carrying value of material capital projects.
Significant accounting estimates - complexity of provisions and accruals	We identified errors totalling £6.5m which were agreed by management and adjusted. None of these individually were above our materiality threshold.
Complexity of accounting and disclosures for TfL's borrowing and treasury management	Our work on Crossrail identified an audit difference in the accounting treatment for an interest free loan provided to Network Rail. This difference was not adjusted by management, the impact was a reduction in receivables of £7.9m charge, a credit of £2.8m to the current year Statement of Comprehensive Income and Expenditure and a debit of £10.7m to opening reserves.
Complexity of accounting for TfL and TTL property portfolio	Our testing has not revealed any material misstatements in respect of accounting for the property portfolio.
Judgmental assumptions impacting on TfL's pension deficit	Our testing has not revealed any material misstatements with respect to pension accounting.

Value for Money

Value for Money

We are required to consider whether Transport for London has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

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



Our detailed findings were reported to the 14 June 2016 Audit and Assurance Committee.

Our value for money conclusion was unqualified. The key findings identified as part of our value for money procedures were as follows:

Key Findings

Sustainable resource deployment – Significant risk

TfL has significant financial risks in its business planning to 2020/21. 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 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

TfL routinely engages with partners and other third parties in order to deliver strategic priorities. 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. Our work was extended and incorporated review of procurement process for significant contracts awarded in the year, review of project governance and oversight and additional work on the Garden Bridge project.

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.



Other Reporting Issues

Other Reporting Issues

Annual Governance Statement

We are required to consider the completeness of disclosures in Transport for London’s annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it complies with relevant guidance.

We completed this work and did not identify any areas of concern.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by Transport for London or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

The matters reported are shown below and are limited to those deficiencies that we identified during the audit and that we concluded are of sufficient importance to merit being reported.

Description	Impact
IT General Controls	
During our testing we identified a number of accounts with privileged access to SAP where key duties/responsibilities were not segregated.	Where such privileged access accounts exist, there is a risk that an individual could develop and migrate changes in the system without appropriate approval or could create and make amendments to key transactions such as payroll runs. We have recommended that the use of privilege access is reviewed and restricted.

We will write separately with a more detailed report on recommendations on internal control relating to less significant points.

EY | Assurance | Tax | Transactions | Advisory

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ED None

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