Audit and Assurance Committee

Date: **11 October 2016**

Item: **External Audit Plan TfL, TTL and Subsidiaries - Year Ending 31 March 2017**

This paper will be considered in public

1 Summary

1.1 To present to the Audit and Assurance Committee EY's plan for the audit of the financial statements of Transport for London, Transport Trading Limited and its subsidiaries for the year ending 31 March 2017.

2 Recommendation

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

3 Background

3.1 The Plan has been developed by EY, and sets out the work that they propose to undertake for the 2016/17 financial year. The Plan sets out the audit strategy and approach for the audit of the financial statements and also encompasses work relating to Value for Money.

3.2 As was the case for 2015/16, a majority of the subsidiaries of the TfL group will be claiming exemption from audit this year and the Audit Plan has been drawn up on this basis.

3.3 The proposed total fee for the audit of the TfL Group, excluding the Museum companies and LTIG, for the year ending 31 March 2017 is £895,925, unchanged from the previous year.

List of appendices to this report:

Appendix 1 - Financial Statements Audit Plan 2016/17 from EY

List of Background Papers:

None

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Appendix 1

Transport for London

Audit Plan for the year ending 31 March 2017

Presented to the Audit and Assurance Committee

11 October 2016

Building a better working world

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Transport for London
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30 September 2016

Dear Members of the Audit and Assurance Committee

We are pleased to attach our 2016-2017 audit plan for consideration at the forthcoming meeting of the Audit and Assurance Committee. The purpose of this report is to provide the Audit and Assurance Committee with a basis to review and validate our initial risk assessment, proposed audit approach and scope.

The Transport for London (TfL) Group and Corporation audits form part of our framework contract with Public Sector Audit Appointments Limited. We will complete 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 subsidiary, Transport Trading Limited Group (TTL) and certain TTL subsidiary companies. TfL's subsidiaries are subject to the accounting requirements of the Companies Act 2006. We will complete our work in 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 11 October 2016.

Yours faithfully

Karl Havers
For and on behalf of Ernst & Young LLP

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Executive summary

Our audit is driven by our assessment of the financial statement risks facing Transport for London as a Group. This is then overlaid by our assessment of risks in 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.

Following completion of the 2015/16 audit, we have initiated our planning procedures for 2016/17. This has included reassessing risks inherent in your market, the key strategic, operational and tactical risks for the Transport for London Group ('TfL') and our knowledge of other factors that may impact the TfL's financial statements. These outputs have been compared with those risks identified through your own risk management process and mapped to the financial statements where applicable. This risk assessment process informs where we focus our audit work risk assessment.

One key change from 2015/16, is that now that as this will be our second year as auditor, we are able to use the knowledge and experience gained in 2015/16, to re-assess our testing thresholds and increase the tolerable error used from 50% to 75% i.e. £82.65 million (2015/16: £55.1 million).

The most significant change in our risk assessment compared to 2015/16, is the impact of the new requirement to include the measurement of the Highways Network Asset on a Depreciated Replacement Cost (DRC) basis. The estimate of the value to be recorded is £17.3 billion. With the asset category containing infrastructure totalling £2.7 billion for the Corporation as at 31 March 2016, the adoption of the measurement requirements of the CIPFA Highways Network Asset Code is anticipated to have a significant impact on the composition of TfL's Balance Sheet.

1. Risk based approach to audit planning

Financial

- Pensions accounting and impact of potential changes
- Financial shared service centre – effectiveness of control environment
- Treasury – controls and valuation of borrowing and investments
- Accounting complexity – Highways Network Assets

Strategic

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

TfL

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.

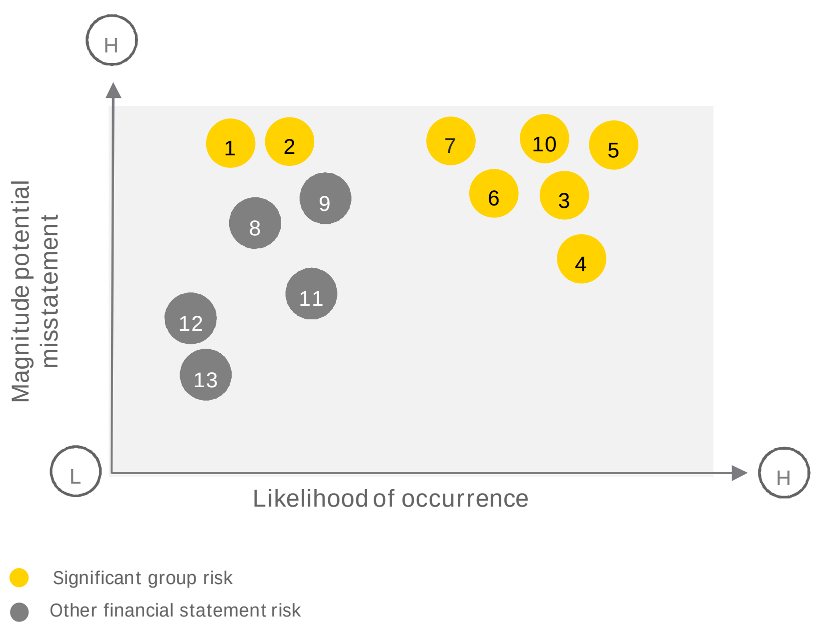
Compliance

- 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

2. Significant financial statement and VfM audit 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 and testing of the effectiveness of key controls designed to address the risks. Further information on our initial assessment of significant audit risks and planned audit procedures is set out at Appendix A.

Our initial financial statement risk assessment



Financial statement risks
1. Management override of controls, required by ISA (UK and Ireland) 240
2. Inappropriate Revenue Recognition , required by ISA (UK and Ireland) 240
3. Inappropriate capitalisation or potential impairment of capital projects
4. Significant accounting estimates, including complexity of provisions and accruals
5. Complexity of accounting for TfL's property portfolio
6. Judgemental assumptions impacting on TfL's pension deficit
7. Complexity of accounting and disclosures for TfL's borrowing and treasury management
8. Consolidation of TTL and subsidiaries
9. Effectiveness of controls within the FSC and for diversified revenue streams, such as Contactless payment.
10. Implementation of changes in accounting for Highways Network Assets.
11. Assessment of the Group boundary – Accounting for Joint Ventures and associates
12. Changes and compliance with IFRS and CIPFA Code of Practice for Local Authority Accounting.
13. Presentation of sensitive disclosures

Financial statement risks for TTL Group and subsidiaries
All identified financial statement risk above are applicable to the TTL Group and subsidiaries except for risks 6, 7 and 10.

Fraud risks and risk of management override

- The risk of fraud exists in any business. Under auditing standards, there is a presumed risk of fraud in connection with revenue recognition. Fraud involving the manipulation of results to achieve performance targets would be harmful to stakeholder perception. For this reason, we have not rebutted the presumed risk of fraud from revenue recognition.

- Under professional auditing standards, our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud. To address the increased potential risk arising from manipulation of results to achieve performance targets, we consider on all our audit engagements the incentives and opportunities for individuals to override internal controls in our audit procedures.

3 Audit scope

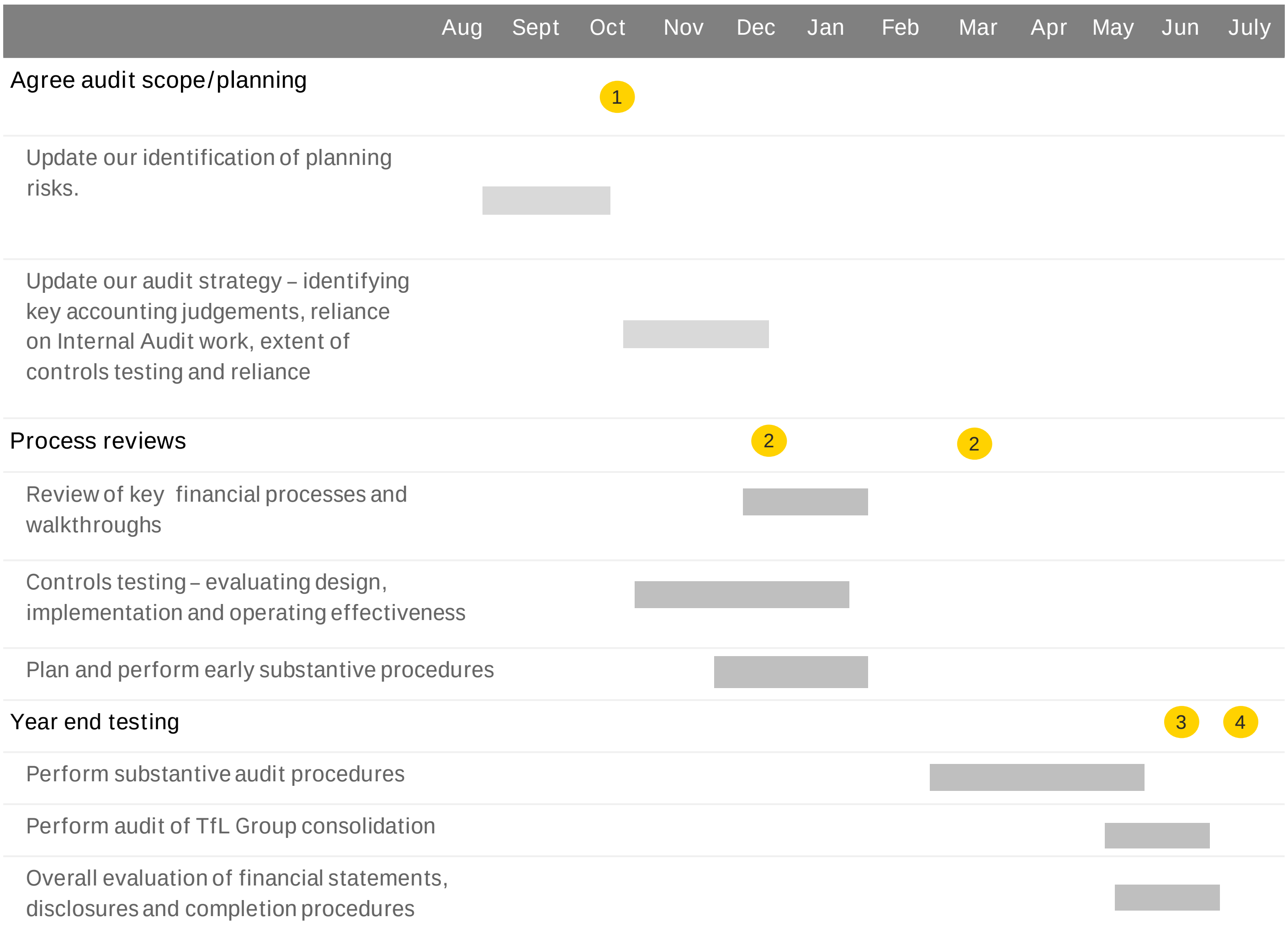
The table below sets out the detailed scope of services and deliverables we have been appointed to provide in FY16.

	Services and deliverables
Financial reporting - Audit of TfL Corporation, Group and TTL Group financial statements	► Express opinions on, and report to Audit and Assurance Committee the results of our audits of the consolidated results of the TfL Corporation, Group and TTL Group. We determine whether the accounts are free from material error, details set out in Appendix C. ► We are required to satisfy ourselves that the 2016-2017 accounts of the TfL and TTL Groups comply with statutory and professional accounting requirements. ► For TfL, this will also include the CIPFA IFRS based Code of Practice on Local Authority Accounting. ► We will provide audit opinions on the consolidated financial statements of TfL and TTL as well as certain of its subsidiaries. ► For the year ended 31 March 2017, as TTL, the holding company for TfL's trading subsidiaries will offer a guarantee in respect of all liabilities to a majority of its subsidiaries, TfL is proposing to apply section 479A of the Companies Act 2006 that enable certain UK subsidiary companies to claim exemption from the audit of their accounts. Our provisional assessment of the scope of our audit for TfL and TTL subsidiaries is set out at Appendix C. ► We will complete a: • Full scope statutory opinion audit of the TfL and TTL Group, Victoria Coach Station and Crossrail financial statements and disclosure notes. • Review the controls over the completion of the accounts. • A review of the consolidation process and testing of journals relating to consolidation adjustments for TfL and TTL Group Accounts.
Internal control communications	► Appendix C sets out how we intend to gain assurance through TfL's control environment. We will provide our views on control environment, including feedback on any areas for improvement compared to what we see as best practice.
TfL Value for Money Conclusion and Whole of Government Accounts	► Under the 2014 Local Audit and Accountability Act and National Audit Office's Code of Audit Practice, we are also required to issue a statutory Value for Money conclusion on TfL's arrangements to secure economy, efficiency and effectiveness in its use of resources. Appendix B sets out our planned audit work. In addition, we are also required to: • Review TfL's Annual Governance Statement to confirm that it is consistent with our understanding of your business and operations. • Audit and provide an opinion to the National Audit Office on the Whole of Government Accounts consolidation pack.

4. Audit scope: Delivery timetable

We set out below a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you. We will agree a detailed timeline of audit activities with key contacts at TfL Group, TTL and Crossrail.

We will provide formal reports to the Audit and Assurance Committee, set out below. From time to time matters may arise that require immediate communication with the Audit and Assurance Committee and we will discuss them with Audit and Assurance Committee Chair as appropriate.



Deliverables to TfL and the Audit and Assurance Committee

1. 31 March 2017 Audit Planning Report
2. Where required, update on Audit Strategy, including control observations
3. Audit Results Report for the year ended 31 March 2017
4. Issue audit opinion on the TfL Corporation, Group, TTL Group and relevant subsidiaries by the end of July 2017.

For TfL Group and Corporation, in October 2016, we will also issue an Annual Audit Letter, providing a summary of our audit work and findings.

5. Service delivery: Audit fees

The audit fees were agreed as part of the tender process and below is a summary of the agreed fees for the TfL Group and Corporation and the TTL Group. Our 2016/17 Audit Fee letter for Transport for London Group and Corporation was presented to you on the 14 June 2016. We have not considered it necessary to make any changes to the agreed fees at this stage.

Agreed fee for the 2016-2017 audit of TfL Group, Corporation and TTL Group (£)

Element of the audit	2016/17 planned fees (£)	2015/16 planned fees (£)
Transport for London Corporation and Group	155,925	155,925
TTL Group	740,000	740,000
Total	895,925	895,925

Assumptions

1. For the 2016/17 financial year, the Audit Commission (now Public Sector Audit Appointments Limited) set the scale fee for Transport for London Corporation and Group. The scale fee is based on the tendering of contracts in March 2014 and is not liable to increase during the remainder of our contract without a change in the scope of our audit responsibilities. Any variation to our planned fees needs to be approved by Public Sector Audit Appointments Limited.
2. The 2016/17 fees are based on certain assumptions, including:
   - Relevant factors, including audit risk and complexity, are not significantly different from those used by the Audit Commission and the previous auditors.
   - The overall level of risk in relation to the audit of the financial statements is not significantly different from that of the prior year.
   - We find no significant weaknesses in your financial control environment at FSC, the financial closedown process and the consolidation of TTL subsidiaries into TTL group, and then to TfL Corporation.
3. We will discuss with the Chief Finance Officer and then report to the Audit and Assurance Committee any proposed variations to our audit fees.

Regarding the 2015/16 planned fees noted above, we are in the process of agreeing with the Chief Finance Officer our estimate of the additional fees arising from additional work during the audit, for both TFL Corporation and TTL in respect of the 2015/16 audit, as outlined in the paper presented at the 14 June 2016 Audit and Assurance Committee. We will report to the Audit and Assurance Committee the final proposed variations to our 2015/16 audit fees.

Fees for open book audits and other related assurance and non-audit services will be discussed with you on a project-by-project basis.

We will present a regular update to the Audit and Assurance Committee on our fees for additional assurance and non-audit audit services. We have commenced a project to assist TfL in strengthening the Risk Management Framework to ensure it is aligned to leading practices in this area, and with similar external organisations; this includes facilitating a Strategic Risk Workshop for Audit and Assurance Committee (AAC) in October.

Appendix A - Accounts with significant risks and our planned audit procedures

We detail the significant risks below along with how we propose to address those risks. As we conclude our planning work across TfL Group, we will update the Audit and Assurance Committee on any significant changes to our risk assessment and planned audit procedures.

Area of emphasis	Summary of planned audit procedures
Management override of controls 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 will: • Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. • Review accounting estimates for evidence of management bias. • Review the business rationale for unusual transactions. • Consider the effectiveness of management's controls designed to address the risk of fraud. • Understand the oversight given by those charged with governance of management's processes over fraud.
Inappropriate Revenue recognition, required by ISA (UK & Ireland) 240 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. Conditions are attached to the grant and project funding which must be met if future funding is to continue. • Commercial development, including advertising and property rental and development.	For both TfL, TTL groups and subsidiaries, we will: • Perform disaggregated and predictive analytical procedures across all revenue streams. • Obtain KPMG's ISAE3402 findings and assess any issues arising. • Test grant funding to assess if revenue has been recognised in accordance with the agreement and conditions set. • Perform extended cut-off procedures, pre and post year end. • Test transactions where we are not able to place reliance over the controls in place or where procedures above are not sufficient.

Area of emphasis	Summary of planned audit procedures
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 2015-2016 financial year, TfL's capital expenditure was £4.1 billion. 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, TTL groups and subsidiaries we will: • Review a sample of capital projects, including all material capital projects and consider risk registers for each of those projects selected. We will particularly examine the Crossrail project. • Understand key controls and governance surrounding capital project accounting and management. • Meeting with management and project managers during the year and attending management's P12 accruals meetings • Evaluate management's judgements and assumptions used in determining the future benefits expected from the projects and ensuring they are appropriate and supportable. • Consider pain/gain arrangements and related accounting treatment. • Review whether or not capitalisation of costs is appropriate. • Consider whether at any stage assets need to be impaired or written off to reflect any aborted or higher risk projects. • Perform detailed testing on a sample of expenditure incurred and capital accruals to source documentation.
Significant accounting estimates – 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 (£120.6 million as at 31 March 2016) 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 will: • Review material provisions and accruals for business purpose and appropriateness of estimation techniques. • Calculate the sensitivity of the provisions to changes in assumptions used for discount rates and inflation to determine if this is material. • Review and critically evaluate management's judgement and estimates applied in the calculation of provisions in the financial statements.

Area of emphasis	Summary of planned audit procedures
Complexity of accounting for TfL and TTL property portfolio 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, TTL group and subsidiaries, we will: • Discuss with management and review evidence to gain understanding of TfL and TTL group property portfolio. • Discuss and review valuation assumptions made by external valuers along with the TfL Property team. • Perform substantive testing and corroborate explanations for property additions, disposals and accounting for lease contracts. • Assess the classification of TfL and TTL property portfolio, the valuation basis and any material increases or impairments that arise during 2016/17. • Assess the work of TfL's property valuers. We will use our EY Estates team as appropriate to review and test the accounting entries and disclosures made in the financial statements. • Review Infrastructure and office buildings, PFI accounting models and appropriateness of accounting and disclosures. We will use our EY Estates team and PFI experts as appropriate to review and test the accounting models, where new arrangements have been put in place in 2016/17.
Implementation of changes in accounting for Highways Network Assets for 2016/17 With effect from the 2016/17 financial year, TfL is required to adopt the measurement requirements of the CIPFA Highways Network Asset (HNA) Code. This requires the measurement of the Highways Network Asset on a Depreciated Replacement Cost (DRC) basis. The estimate of the value to be recorded is £17.3 billion. With the asset category containing infrastructure totalling £2.7 billion for the Corporation as at 31 March 2016, the adoption of the measurement requirements of the CIPFA Highways Network Asset Code is anticipated to have a significant impact on the composition of TfL's Balance Sheet. Due to this being a new requirement for 2016/17 and the significant asset base subject to the measurement requirements of the HNA Code, we deem this to be a significant risk for 2016/17.	For TfL, we will: • Discuss with management and review TfL's methodology to record the inventory subject to the HNA code, ensuring that this inventory record is materially both accurate and complete. • Perform substantive testing on the measurement basis applied to the affected assets to ensure that this has been performed in compliance with the requirements of the HNA Code.

Area of emphasis	Summary of planned audit procedures
Judgmental assumptions impacting on TfL's pension deficit At the 31 March 2016, TfL's defined pension schemes has a deficit of £3.2 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.	We will: • Review the actuarial report and fund actuary triennial valuation. We will test the reasonableness of key actuarial assumptions. • Seek to rely on information from KPMG in terms of their audit of investment fund/asset values and membership data submitted to the actuary as KPMG are the auditors of the TfL Pension Fund • Use our EY pensions specialist as appropriate to support us with this work and to review the appropriateness of the IAS19 valuation methodology. • Review the disclosure of deficit and assumptions in the financial statements to ensure that it is fair, balanced and understandable
Complexity of accounting and disclosures for TfL's borrowing and treasury management 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 including investing in approved counterparties in Euros and US Dollars and an interest free loan to Network Rail. • 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 will: • Review TfL's borrowing portfolio and compliance with its prudential indicators. • Assess the reasonableness of TfL's borrowing, against its financial, business plans as part of our assessment of going concern. • Review and where appropriate challenge management's assessment on hedge forecasting. We will involve our EY Treasury expert to review managements assumptions. • Review accounting policies and disclosures against IAS39 and IFRS7.

Appendix B - Value for Money Conclusion

Under Section 20(1) of the Local Audit and Accountability Act 2014, we are required to satisfy ourselves that Transport for London Corporation has put in place 'proper arrangements' to secure economy, efficiency and effectiveness in its use of resources.

For 2016/17 this is based on the overall evaluation criterion:

- *"In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people"*

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.

A summary of our initial risk assessment and planned audit response shown below.

Sustainable resource deployment – Significant audit risk

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. 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. We will:

- Assess the achievement of the 2016/17 budget and the adequacy of the 2017/18 budget setting process and we will consider the assumptions, scenarios, options and risks TfL is facing and how these are being managed.
- Consider the assumptions, scenarios, options and risks TfL is facing and how these are being managed.
- Review and understand TfL's medium to longer term financial planning and how this is reflected in the 2021/22 Business Plan to be published in December 2016. We will assess the savings plans in place, and the likelihood of whether these plans can provide the Corporation with the required savings/efficiencies over the medium term.

TfL

Informed decision making

We will keep the following areas under review:

- Understanding the organisation changes that are underway and how these changes will strengthen TfLs decision making arrangements.
- How the finance function supports management with clear, summarised and insightful financial and performance information for decision making.

Working with partners and other third parties

We will keep the following areas under review:

- How TfL exercises governance and oversight over key project areas, significant contracts and procurement.
- How TfL plans for and considers and addresses the financial and legal risks it is exposed to for these projects.

Appendix C - Audit scope and execution Materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality also provides a basis for identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

As we conclude our planning activities, we will continue to review a range of bases to calculate materiality, including, total assets, total revenue expenditure, total expenditure (including revenue and capital). We welcome the Audit and Assurance Committee's observations on the factors we should consider in arriving at an appropriate basis for setting materiality at and across the TfL Group.

At this stage, we consider the most appropriate basis for assessing planning materiality for the Group to be total gross expenditure, as TfL is able to reallocate between operating and capital expenditure. We also think TfL is most significantly measured by users of the financial statements with respect to the costs incurred on maintaining the Transport for London service, capital programme, investment in infrastructure and annual activity.

The table below shows the planned results if we used total gross expenditure as the basis for materiality. To mitigate the risk of an unidentified material misstatement, all testing is performed using a threshold of tolerable error. The EY methodology requires us to set this at either 50% or 75% of materiality. The decision as to whether 50% or 75% is appropriate is based on the assessment of the particular circumstances of the TfL Group, taking into account factors such as the control environment, changes in the Group, risk assessment and the expectation of the level of misstatements. We have determined, based on our knowledge gained in our first year (2015/16) audit, that we can plan the 2016/17 audit using a tolerable error is set at 75%, or £82.65 million (2015/16: £55.1 million).

2015/16 results	Group £'billion	Percentage used	Preliminary Planning Materiality £'million
Total gross expenditure – capital and revenue	11.020	1.0%	110.2

The amount we consider material at the end of the audit may differ from our initial determination. We will form our final opinion by reference to all matters that could be significant to users of the accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date. We will also consider the nature of any audit misstatements identified to determine if there are other factors that could result in errors that may appear immaterial quantitatively but which are material qualitatively.

In establishing our audit scopes we will set thresholds for the work being audited at TTL and its subsidiaries, such that local materiality levels are lower than the TfL Group amount.

Appendix C - Audit scope and execution

Gaining assurance through the control environment

Internal controls over financial reporting

We will update our understanding of the internal controls over financial reporting used throughout the TfL and TTL Group, with the intention of using a controls-based audit approach again, where we expect this to be robust and efficient. To be able to adopt an efficient controls-based approach, we consider the various layers of assurance and leverage where there is potential to do so, shown in the diagram below. In particular, we review:

- Entity level controls; we will maximise efficiency by seeking to rely on entity level controls and processes, such as budget setting and monitoring process.
- IT systems and applications: we will test the general IT controls built in to the TfL Group's core IT applications, together with IT application controls over your critical business processes. We will consider how TfL has implemented our recommendations from 2015/16 and assess the impact on our audit approach, particularly in respect of privilege access rights.
- Controls within key processes such as purchase to pay, where we will consider whether any changes have been made to the process to enable us to test and rely on controls.
- Assurance reports from third parties such as ISAE3402 reporting from KPMG on revenue and assurance provided by KPMG in respect of the pension fund.

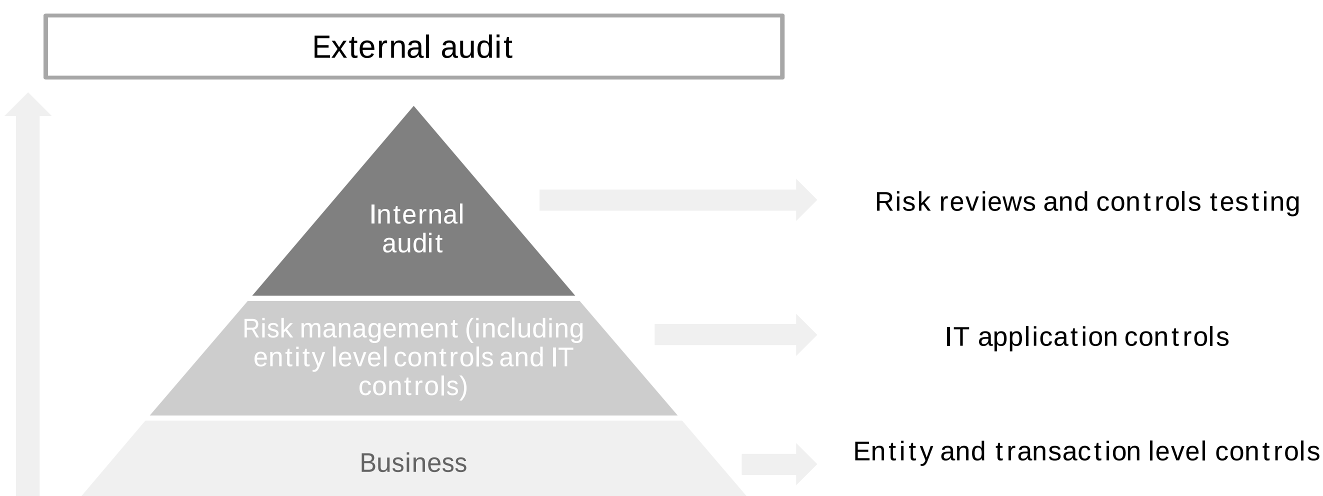
Where we believe that reliance on controls will not be possible due to any ineffective design or operation of the controls, we will provide feedback on areas for improvement compared to what we see as leading practice, and will instead perform additional substantive procedures to support our audit opinion.

Liaising with Internal Audit

A key part of understanding and monitoring of the control environment is our ongoing liaison with Internal Audit. We will develop a strong working relationship with Internal Audit. We will discuss and review Internal Audit's annual plans and reports to inform where specific reviews can assist us in our controls and Value for Money Conclusion work.

Analytics

We will to continue to perform data analysis to support our audit procedures, building on our analytics performed in our 2015/16 on Purchase to Pay, Payroll and Journal Entries.



Appendix D – Independence report

Introduction

In order to carry out our duties and responsibilities as auditor, EY are required to consider our independence and objectivity within the context of the regulatory and professional framework in which we operate.

The APB Ethical Standards and ISA (UK and Ireland) 260 'Communication of audit matters with those charged with governance', requires us to communicate with you on a timely basis on all significant facts and matters that bear upon our independence and objectivity. The Ethical Standards, as revised in December 2010, require that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of the audit if appropriate. The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

Required communications	
Planning stage	Final stage
• The principal threats, if any, to objectivity and independence identified by EY including consideration of all relationships between the you, your affiliates and directors and us; • The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review; • The overall assessment of threats and safeguards; • Information about the general policies and process within EY to maintain objectivity and independence.	• A written disclosure of relationships (including the provision of non-audit services) that bear on our objectivity and independence, the threats to our independence that these create, any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed; • Details of non-audit services provided and the fees charged in relation thereto; • Written confirmation that we are independent; • Details of any inconsistencies between APB Ethical Standards and your policy for the supply of non-audit services by EY and any apparent breach of that policy; and • An opportunity to discuss auditor independence issues.

In addition, during the course of the audit, we are required to communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place, for example, when accepting an engagement to provide non-audit services.

We also provide information on any contingent fee arrangements, the amounts of any future services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted.

We ensure that the total amount of fees that EY and our network firms have charged to you and your affiliates for the provision of services during the reporting period, analysed in appropriate categories, are disclosed.

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including the principal threats, if any. However we have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective.

Self interest threats

A self interest threat arises when EY has financial or other interests in your company. Examples include where we have an investment in your company; where we receives significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with you. At the time of writing, there are no long outstanding fees.

A self interest threat may also arise if members of our audit engagement team have objectives or are rewarded in relation to sales of non-audit services to you. We confirm that no member of our audit engagement team, including those from other service lines, has objectives or is rewarded in relation to sales to you, in compliance with Ethical Standard 4.

Self review threats

Self review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements

Management threats

Partners and employees of EY are prohibited from taking decisions on behalf of management of your company. Management threats may also arise during the provision of a non-audit service in relation to which management is required to make judgements or decision based on that work.

Other threats

Other threats, such as advocacy, familiarity or intimidation, may arise.

We believe that it is appropriate for us to undertake permissible non-audit services and we will comply with the policies that you have approved. In addition, when the ratio of non-audit fees to audit fees exceeds 1:1, we are required to discuss this with our Ethics Partner, as set out by the APB Ethical Standards, and if necessary agree additional safeguards or not accept the non-audit engagement. We will also discuss this with you.

Overall Assessment

Overall, we consider that the safeguards that have been adopted appropriately mitigate the principal threats identified and we therefore confirm that EY is independent and the objectivity and independence of Karl Havers, your audit engagement partner and the audit engagement

Other required communications related to independence matters

EY has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained.

Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for 2015 and can be found at:

http://www.ey.com/UK/en/About-us/EY-UK-Transparency-Report-2015

Appendix E – 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 this 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
 	
► Findings and issues regarding the opening balance on initial
 	
► 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.
	These matters will be included within our Audit Results Report for the year ending 31 March 2017

	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	These matters will be included within our Audit Results Report for the year ending 31March 2017.
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	We will discuss this with you at our meetings with the Audit Committee at both Planning and Final stages. Any instances ide notified will be included in the appropriate report as necessary.
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	If applicable this will be included, as necessary, within our Audit Results Report for the year ending 31 March 2017.
External confirmations ► Management's refusal for us to request confirmations ► Inability to obtain relevant and reliable audit evidence from other procedures	If applicable this will be included, as necessary, within our Audit Results Report for the year ending 31 March 2017.
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	If applicable, this will be included, as necessary, within our Audit Results Report for the year ending 31 March 2017.

	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	These matters are included within this report and will also be included within Audit Results Report for the year ending 31 March 2017.
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	If applicable this will be included, as necessary, within our Audit Results Report for the year ending 31 March 2017.
Significant deficiencies in internal controls identified during the audit	This will be included within our Report on the Control Environment and, if necessary, within our Audit Results Report for the year ending 31 March 2017

	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	These matters are included within this report and will also be included within Audit Results Report for the year ending 31 March 2017.

EY | Assurance | Tax | Transactions | Advisory

Ernst & Young LLP

ED None

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