Audit and Assurance Committee

Date: **8 October 2015**

Item: **External Audit Plan TfL, TTL and Subsidiaries - Year Ending 31 March 2016**

This paper will be considered in public

1 Summary

1.1 To present to the Committee Ernst &Young's (EY) plan for the audit of the financial statements of Transport for London, Transport Trading Limited and its subsidiaries for the year ending 31 March 2016.

2 Recommendation

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

3 Background

3.1 The Plan has been developed by the newly appointed Auditor, EY, and sets out the work that they propose to undertake for the 2015/16 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 2014/15, a majority of the subsidiaries of the TfL group will be claiming exemption from audit again 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 London Transport Insurance Guernsey, for the year ending 31 March 2016 is £895,925. This represents a reduction of £237k compared with that for the previous year.

3.4 The fee for TfL Corporation and Group is reduced by 25 per cent or £52k from the previous year following further reductions imposed by the Audit Commission, now Public Sector Audit Appointments Limited.

3.5 The reduction in the fee proposed for TTL Group of 20 per cent reflects the outcome of last year's competitive tendering for the TTL audit.

List of appendices to this report:

Appendix 1: Financial Statements Audit Plan 2015/16 from EY.

List of Background Papers:

None

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Appendix 1

Transport for London

Audit Plan for the year ending 31 March 2016

Presented to the Audit and Assurance Committee

8 October 2015

Building a better working world

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The Audit and Assurance Committee
Transport for London
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29 September 2015

Dear Members of the Audit and Assurance Committee

We are pleased to attach our 2015/16 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.

Since our appointment as auditors, over the past six months we have completed a range of transition and audit planning activities. We have used this to form our initial observations on your key business and financial statement risks and how this will drive an effective audit for TfL and its subsidiaries. Our planning work remains in progress. We are finalising our review of the audit files of your previous auditor and we are yet to document and evaluate TfL's core financial systems. We will update you at the 8 December 2015 Audit and Assurance Committee if we intend to make any significant changes to our assessment of audit risk and the scope of our work.

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 subsidiaries, 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 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 8 October 2015.

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.

1. Risk based approach to transition and audit planning

Since our appointment as auditors of TfL, we committed to and have substantially completed a range of transition and audit planning activities.

Meeting Senior Management and Functional Leaders

- We have held a number of meetings with members of the executive and functional leaders to gain a detailed understanding of the TfL group, its core objectives and the challenges, risks and opportunities it faces.
- Continuing meetings with the senior finance team; combined with meetings with function leaders in Crossrail, the Financial Shared Service Centre, Treasury Management, Internal Audit, Pensions, Risk Management; Tax, IT and Property/ Commercial Development. We have also met KPMG LLP as your predecessor auditor.
- Attendance at Audit & Assurance Committee and shadowing 2014/15 audit closeout meetings held by KPMG LLP.

Review of strategic documentation

- Detailed review and assessment of documents that cover TfL's strategic, business and financial planning and its assessment of risk.
- Detailed technical analysis of group financial reporting focusing on the TfL Corporation single entity and group accounts for 2013/14 and 2014/15 that are prepared under the Local Authority Accounting Code of Practice.

Validating our initial observations and audit risks

- We shared our initial observations with TfL senior officers to confirm our understanding of the Corporation's key strategic, business and financial risks.
- The following sections of this report set out how our observations from these transition activities have informed our initial assessment of audit risk as well as the scope and timing of our work.

Review of previous auditors files and financial systems

- In September 2015, we are completing a review of KPMG LLP's prior year audit files. We will use this to confirm our understanding on the business and audit risks present at TfL Corporation and its subsidiaries. We will also use this to further understand the control environment governing TfL's key financial systems.
- From August 2015, we have and will continue to document and evaluate the material financial systems throughout the TfL group. We will walkthrough the key controls within those systems, particularly at the Financial Shared Service Centre and Crossrail.

Refining and updating our audit risks and scope

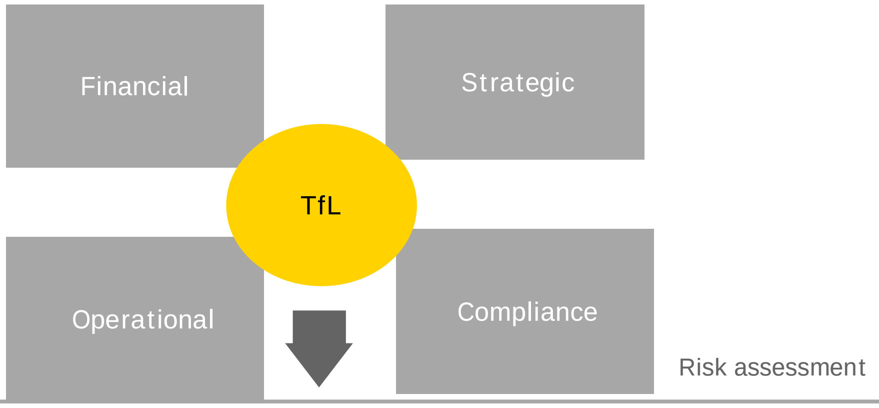
- Although we have undertaken a wide range of activities already, it is of course only two months since KPMG LLP completed their 2014/15 audit.
- By November 2015, the National Audit Office will have also finalised its auditor guidance notes for the VFM conclusion.
- Therefore, the nature and significance of our audit risks will continue to evolve as we complete our planning activities and review the financial systems and controls. We will update the Audit & Assurance Committee throughout the year if we make any significant changes to our assessment of audit risk and the scope of our work.

2. Significant financial statement and VfM audit risks

Our transition and initial planning activities have identified the following financial statement and value for money significant risks and the significant components of the business where we will focus the audit. We welcome the Audit and Assurance Committee's observations on our initial risk assessment as well as to understand whether there are any other matters which may influence our audit. As we conclude our planning work, we will update the Audit and Assurance Committee if we make any significant changes to our assessment of financial statement and VFM audit risks and the scope of our work.

Significant audit risks

Significant risks identified for the audit include only those risks that could have an impact on the financial statements. Whilst the strategic, operational and compliance risks are important and have been considered in our overall risk assessment, they do not all lead directly to financial statement risks in the current year.



Financial risks

- Financial shared service centre and effectiveness of the control environment
- Treasury – controls and valuation of derivatives and investments
- Accounting complexity – consolidation, Transport Infrastructure Assets, outsourcing
- Judgemental assumptions impacting on pensions deficit

Strategic risks

- Future funding, volatility in capital markets, delivery of savings and efficiency targets
- Strategic changes impacting cash flow and asset values, e.g. commercial development
- Delivery of capital and surface transport investment programmes
- Fraud risk from management override

Operational risks

- IT systems failure and corruption, e.g. ticketing systems, asset registers, data protection
- Revenue processes and recognition
- Claims resulting from failure, e.g. major events, contract failure, EU air quality targets, industrial relations
- Cyber and information security incident – responding to the threat as fast as it evolves
- Robustness of procurement and contract management processes

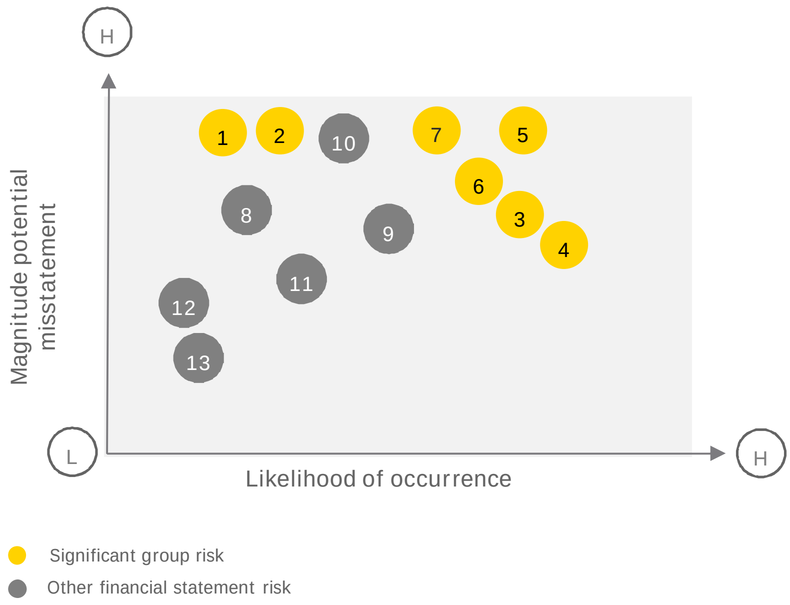
Compliance risks

- Accuracy of claims and provisions, e.g. Compulsory Purchase Orders
- Impact of legislative change
- Fixed asset management, classification and valuation

Financial statement 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. Judgemental assumptions impacting on valuation of TfL and TTL 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 Transport Infrastructure Assets for 2016/17.
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 TfL Group and subsidiaries
All identified financial statement risks above are applicable to the TfL 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. For TfL, a large proportion of revenue is generated using either cash or contactless payments. TfL is continuing to diversify its sources of revenue. 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 results of the TfL Corporation, and the consolidated results of the TfL 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 2015/16 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 ending 31 March 2016, 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, the group 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.

	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	July
Agree audit scope/planning			1									
Conclude transition activities. Agree service commitments and identification of planning risks.												
Develop audit strategy – identifying key accounting judgements, reliance on Internal Audit work, extent of controls testing and reliance.												
Process reviews					2			2				
Review of key financial processes and walkthroughs												
Controls testing – evaluating design, implementation and operating effectiveness												
Plan and perform early substantive procedures												
Year end testing											3	4
Perform substantive audit procedures												
Perform audit of TfL Group consolidation												
Overall evaluation of financial statements, disclosures and completion procedures												

Deliverables to TfL and the Audit and Assurance Committee

1. 31 March 2016 Audit Planning Report
2. Update on Audit Strategy, including control themes and observations
3. Audit Results Report for the year ending 31 March 2016
4. Issue audit opinion on the TfL Corporation, Group, TTL Group and relevant subsidiaries by the end of July 2016.
   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: Your TfL and TTL audit team

The TfL Group engagement team is led by Karl Havers from our London office.

We established our engagement team with the principle of providing the right blend of industry, sector and technical experience to execute the audit and deliver on our commitments to you. This engagement team has been set up to mirror your organisational structure.

Coordinating Partner for TfL and TTL Group
Lead Audit Partner for TfL Group and Corporation
Karl Havers

Lead Audit Partner for TTL
Kath Barrow

Executive Director, for TfL Group and Corporation
Neil Harris

Executive Director, for TTL
Caroline Mulley

Senior Audit Manager for Crossrail
Andrew McGowan

Quality and Transition

Quality Review Partner

Transition Director
Andrew Brittain

Subject matter experts and insight specialists

IT Partner
Richard Brown

Cyber Security
Mark Brown

Pensions
Iain Brown

Valuations
Mark Gerold

Public Sector Accounting, including Infrastructure Assets
Neil Gibson

Direct Tax
Nick Wilson

VAT
Audrey Fearing

Treasury
Craig Kennedy

PAYE
Jim Boylan

Transport Risk Management
Barbara Carvalho

Transport Systems
Gianluca Favaloro

Bond Expert
Chris Lowe

Finance back office optimisation
Andrew Gray

TfL Group and Corporation	TTL Group and subsidiaries
Senior Manager Philip King	Senior Manager Graeme Baguley
Manager Gary Belcher	Manager Cameron Ellis

6. 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 2015/16 Audit Fee letter for Transport for London Group and Corporation was presented to you on the 16th June 2015. We have not considered it necessary to make any changes to the agreed fees at this stage.

Agreed fee for the 2015/16 audit of TfL Group, Corporation and TTL Group (£)

Element of the audit	2015/16 planned fees (£)	2014/15 planned fees (£)
Transport for London Corporation and Group	155,925	207,900
TTL Group	740,000	925,000
Total	895,925	1,132,900

Assumptions

1. Total fees exclude LTIG and London Transport Museum Ltd.
2. For the 2015/16 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 2014/15 fee of £207,900 reduced by 25% following the tendering of contracts in March 2014. It 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.
3. The 2015/16 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 Group.
4. We will discuss with the Chief Financial Officer and then report to the Audit and Assurance Committee any proposed variations to our 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. For example, we are currently finalising the scope of work to review TfL's implementation of changes to accounting requirements for the valuation of Transport Infrastructure Assets. We expect our assurance related fees to be £18,345 for this piece of work.

We will present a regular update to the Audit and Assurance Committee on our fees for additional assurance and non-audit audit services.

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

Following our transition activities and initial planning, page 6 of our plan sets out the significant risks we have identified so far. 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: • £5billion fare revenue (2014/15) generated by cash and contactless payments. • £4.5billion of grant funding (2014/15) 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. • 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. • Transaction testing 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 2014/15 financial year, TfL's capital expenditure was £3.6billion. 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. We will particularly examine the Crossrail project. • Understand key controls and governance surrounding capital project accounting and management. • Evaluate management's judgements and assumptions used in determining the future benefits expected from the projects and ensuring they are appropriate and supportable. • 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.
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 (£188.5million as at 31 March 2015) come from its capital investment activities.	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
Judgemental assumptions impacting on the valuation of TfL and TTL property portfolio TfL and TTL groups have an extensive property estate, valued at £1.061billion as at 31st March 2015. This comprises investment property (£438million), office buildings (£248million) and assets held for sale (£375million). 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 walkthroughs and test controls over property additions, disposals and subsequent recording in SAP. We will then supplement this with substantive testing of documentation 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 2015/16. • 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.

Area of emphasis	Summary of planned audit procedures
Judgmental assumptions impacting on TfL's pension deficit At the 31 March 2015, TfL defined pension scheme has a deficit of £2.9billion. The TfL Group balance sheet includes the deficit on the Public Sector and Tube Lines sections of the TfL Pension Fund, TfL's share of the deficit on the Local Government Pension Scheme and liability for unfunded pensions obligations. The assumptions used to arrive at the value of the pension deficit are highly judgemental. The setting of these assumptions in accordance with IAS19(R) Employment Benefits will be an area of audit emphasis. The Fund Actuary is also due to complete the next cycle of triennial valuations of the pension scheme during the 2015/16 financial year.	We will: • Review the actuarial report and fund actuary triennial valuation. We will test the reasonableness of key actuarial assumptions. • We will also 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. For the first time in 2014/15, TfL invested in approved counterparties in Euros and US Dollars. • TfL must keep its borrowing within prudential limits set by the Mayor as part of Greater London Authority's consolidated budget for its functional bodies and the requirements of the Local Government Act 2003.	We 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 made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We complete this work on a risk based approach, referring to guidance notes issued by the National Audit Office (NAO). The NAO are currently updating and consulting on the guidance notes for 2015/16 audits. We expect this to be finalised by November 2015. We will update the Audit and Assurance Committee on any changes to our strategy as necessary. We expect to reach a conclusion based on a single criteria:

In all significant respects, does TfL take properly informed decisions and deploy resources to achieve planned and sustainable outcomes for taxpayers and local people.

We expect to assess the significance of TfL's business and operational risks against three themes; informed decision making; sustainable resource deployment; and working with partners and other third parties.
A summary of our initial risk assessment and planned audit response so far is shown below. We will revisit this when the NAO's auditor guidance notes are finalised.

Sustainable resource deployment – Significant audit risk

TfL has approximately £5.7billion of quantified financial risks in its business planning to 2020/21. TfL's operations and ongoing Investment Programmes are subject to a number of risks, particularly the exposure to economic risks associated with revenue reductions, grant reduction and financial markets disruption impacting on TfL's ability to borrow. We will:

- Assess the achievement of the 2015/16 budget and the adequacy of the 2016/17 budget setting process.
- Review and understand TfL's medium to longer term financial planning and how this aligns to the 2020/21 business plan. We will consider the assumptions, scenarios, options and risks TfL is facing and how these are being managed.
- Assess the level of financial exposure and oversight that TfL has to significant capital projects. In particular, we will review TfL oversight on the financial and programme management of the Crossrail project.

TfL

Informed decision making

We will keep the following areas under review:

- How the finance function can support management with clear, summarised and insightful financial and performance information for decision making.
- Understanding TfL's risk appetite, effectiveness and synergy with business units.
- Understanding and assessing response to the risk of information or cyber security incident.

Working with partners and other third parties

We will keep the following areas under review:

- How TfL prepares for and responds to the outcome of the 2016 London Mayoral election, considering any impact this and GLA strategy could have on TfL's strategic and financial plans.
- How TfL ensures it has effective governance and decision making for significant contracts and procurement.
- How TfL understands and addresses the risks, from fraud, finance and project delivery to its significant commercial contracts and procurement.

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. 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 threshold of tolerable error is set for the first year of our audit at 50%, or £55.13million.

2014/15 results	Group £'billion	Percentage used	PM planned amount £'million
Total gross expenditure – capital and revenue	11.025	1.0%	110.25

It is therefore likely that we will setting a materiality level lower than that used by your previous auditor in their 2014/15 audit. We will need to consider any lower materiality level when we review the 1st April 2015 opening balance sheet.

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 are now starting our audit work by reviewing internal controls over financial reporting used throughout the TfL and TTL Group, with the intention of using a controls-based audit approach 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 will review:

- IT systems and applications: we will review 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 is managing the risk of cyber and information security incident on its core financial systems.
- Entity level controls; we will maximise efficiency by seeking to rely on entity level controls and processes, such as budget setting and monitoring process.

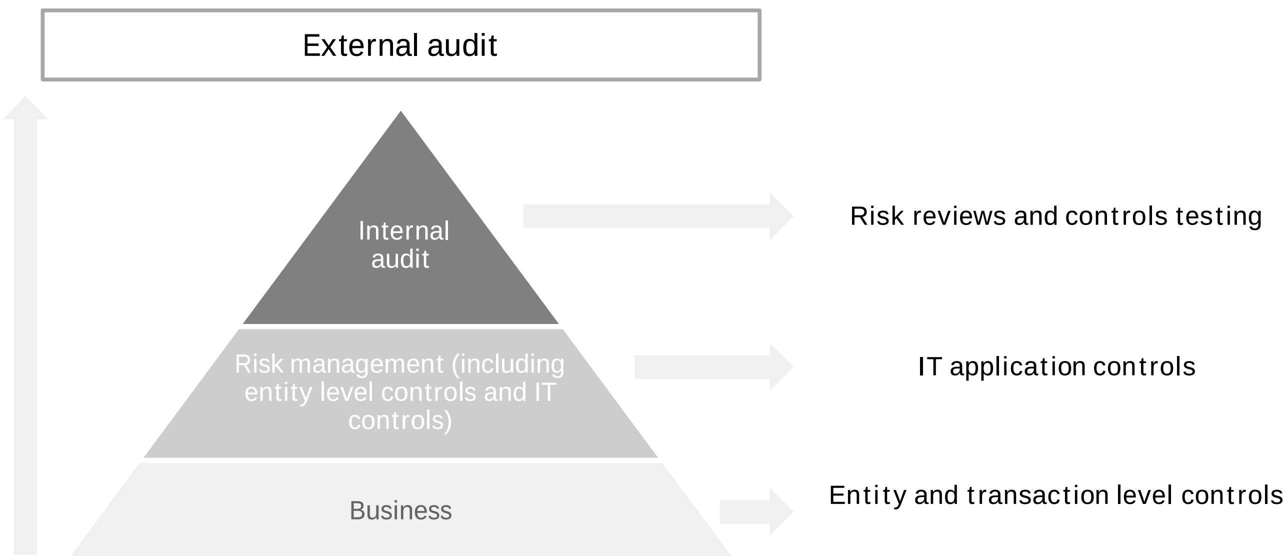
Where we believe that reliance on controls will not be possible due to any ineffective design or operation of the controls, we will provide feedback on areas for improvement compared to what we see as leading practice, and will instead perform additional substantive procedures to support our audit opinion.

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. In our first year as your auditors, we will also review Internal Audit's arrangements and effectiveness. A joint Internal and External Audit protocol will be presented to the December 2015 Audit and Assurance Committee.

Analytics

We expect to perform data analysis to support our audit procedures for Purchase to Pay, Payroll and Journal Entries to cover the full year. We expect to produce a baseline set of analytics similar to that performed by the TfL's previous auditor, but will use analytics to provide audit assurance wherever it is efficient and effective to do so.



Provisional
TfL and TTL Group subsidiary audit scope

Reporting Package	FY15 audit
Crossrail Limited	1
London Underground Limited	1
London Bus Services Limited	1
LUL Nominee SSL Limited	1
LUL Nominee BCV Limited	1
Tube Lines Limited	1
Rail for London Limited	2
Docklands Light Railway Limited	2
Tramtrack Croydon Limited	2
Transport for London Finance Limited	2
London Transport Museum Limited	3
London Transport Museum (Trading) Limited	3
Victoria Coach Station Limited	3
City Airport Rail Enterprises plc	4
Woolwich Arsenal Rail Enterprises Limited	4
City Airport Rail Enterprises (Holdings) Limited	4
Woolwich Arsenal Rail Enterprises (Holdings) Limited	4
London Buses Limited	4
London River Services Limited	4

Scope definitions

1 Full scope

- Significant location based upon size or risk
- Procedures are full scope in nature, but may not be sufficient to issue a stand-alone opinion on the local financial statements
- Controls evaluated and tested for all relevant assertions over all significant accounts
- Audit procedures performed on all significant accounts using materiality levels assigned by the primary office audit team for the consolidated audit

2 Specific scope

- Significant location based upon specific risks
- Controls evaluated and tested for accounts and disclosures affected by specific risks
- Specific audit procedures are performed by the local audit team based upon procedures, accounts or assertions identified by the primary office audit team and using materiality levels assigned by the primary office audit team

3 Statutory scope

- Insignificant location not required to support the consolidated audit opinion
- Statutory audits include full scope audit procedures (including control testing where appropriate) that will be performed separately using local materiality thresholds, in accordance with local statutory reporting requirements

4 No scope for group audit

- Insignificant location not required to support the consolidated audit opinion and with no statutory audit requirements
- Limited, if any, procedures will be performed at these locations

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 the year ended 29 June 2014 and can be found at:

http://www.ey.com/UK/en/About-us/EY-UK-Transparency-Report-2014

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 2016

	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 2016.
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 2016.
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 2016.
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 2016.

	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 2016.
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 2016.
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 2016

	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 2016.
Opening Balances ► Findings and issues regarding the opening balance of initial audits	If applicable this will be included, as necessary, within our Audit Results Report for the year ending 31 March 2016.

EY | Assurance | Tax | Transactions | Advisory

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