Transport for London
Audit results report

Year ending 31 March 2022

Status as of 6 June 2022

EY
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Private and Confidential 31 May 2022

Transport for London
Palestra
197 Blackfriars Road
UK SW1H 0BD

Dear Members of the Audit and Assurance Committee,

2021/22 Audit results report

We are pleased to attach our audit results report, summarising the status of our audit for the forthcoming meeting of the Audit & Assurance Committee. We will update the Audit & Assurance Committee at its meeting scheduled for 06 June 2022 on further progress to that date and explain the remaining steps to the issue of our final opinion.

The audit is designed to express an opinion on the 2022 financial statements and address current statutory and regulatory requirements. This report contains our findings related to the areas of audit emphasis, our views on TfL Group accounting policies and judgments and material internal control findings. Each year sees further enhancements to the level of audit challenge and the quality of evidence required to achieve the robust professional scepticism that society expects. We thank the management team for supporting this process.

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

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

This report is intended solely for the information and use of the Audit & Assurance Committee, Board of Directors and management. It is not intended to be and should not be used by anyone other than these specified parties.

Yours faithfully

Janet Dawson

Partner
For and on behalf of Ernst & Young LLP

Contents

Public Sector Audit Appointments Ltd (PSAA) issued the "Statement of responsibilities of auditors and audited bodies". It is available from the PSAA website (https://www.psaa.co.uk/audit-quality/statement-of-responsibilities/).The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The "Terms of Appointment and further guidance (updated April 2018)" issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.

This report is made solely to the Audit and Assurance Committee and management of Transport for London in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Audit and Assurance Committee and management of Transport for London those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Audit and Assurance Committee and management of Transport for London for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

01 Executive Summary

Executive Summary

Financial statements opinion

In our Audit Plan presented on 01/12/21 we identified a number of key areas of focus for our audit of the financial report of the TfL Group. This report sets out our observations and status in relation to these areas, including our views on areas which might be conservative and areas where there is potential risk and exposure. Our consideration of these matters and others identified during the period is summarised within the "Areas of Audit Focus" section of this report.

Where applicable we have identified those matters we consider to be key audit matters. Key audit matters are selected from the matters we communicate to you that in our opinion are of most significance to the current period audit and required significant attention in performing the audit. In accordance with ISA (UK) 701 key audit matters are included in our auditor's report.

Areas of focus identified during the course of the audit included the following:

- Management override of controls
- Revenue recognition with particular focus on fares revenue
- Inappropriate capitalisation or potential impairment of capital projects including capital accruals
- Complexity of accounting for TfL and TTL property portfolios
- Considerations of whether any assets in the course of construction or existing in use assets are impaired due to potential for reduced capital funding or changes to operational services.

At the time of writing this report, there remains uncertainty as to the ongoing funding available from Government in connection with the operational funding gap created by lower fares revenue and future capital funding. The current funding agreement expires on 24 June 2022. At the current time this would result in a similar opinion to the year ended 31 March 2021, being a material uncertainty surrounding the funding of the Group and therefore its ability to continue to operate the current level of services, including the planned capital programme post 24 June 2022. We understand that there is likely to be an updated agreement covering operational funding from 24 June 2022 and there may be an agreement on capital funding prior to the financial statement sign off. We will therefore update the position once any funding agreement is agreed for the period post 24 June and share our final conclusions, including our draft audit opinion with the Audit & Assurance Committee for review and discussion prior to Board sign off in July.

Executive Summary

Value for money considerations

In terms of the Code of Audit Practice (the 2020 Code) and associated Auditor Guidance Notes (AGN) we are required to report on significant weaknesses in a body's arrangements identified during the course of the audit.

Financial Sustainability
During the execution of our interim audit fieldwork for the financial year ended 31 March 2022 we identified a significant weakness as defined by AGN03 with regards to the financial sustainability of TfL, given there is no long term funding arrangement currently in place. Without a longer-term funding agreement in place, TfL is making short term decisions based on the current funding arrangements. If longer-term funding arrangements were in place, management would be able to make more robust decisions, negotiate better long-term deals with suppliers or contractors and identify synergies and cost saving opportunities. This means that TfL is not obtaining the best value for money due to lack of clarity of long-term funding agreements going forward. As such we have formally communicated on the weakness identified to the Audit and Assurance Committee. Please refer to Appendix A for a copy of the letter.

Improving economy, efficiency and effectiveness
During 2019/20 Transport for London identified a series of weaknesses with the application of procurement rules throughout the organisation. Procurement arrangements were not being followed in all cases, leading to a significant amount of single source tender arrangements and other contracting arrangements that may not have provided value for money. An action plan was put in place to address the weaknesses identified, however our assessment of implementation of procurement improvement programme still in progress. We will update the Audit & Assurance Committee on further progress once we conclude on the matter.

Executive Summary

Audit differences

During our audit work, we identified certain judgemental misstatements which remain unadjusted items and are recorded in our summary of audit differences. The overall impact is a credit of £3m to total comprehensive income, a debit of £98m to non current assets, a credit of £41m to non-current liabilities and a credit of £54m on brought forward reserves. We have yet to complete the audit and the review of the draft financial statements, and therefore further audit differences and disclosure adjustments may be identified. We will report those to the committee before the conclusion of our work.

There are no amounts that we identified that are individually or in aggregate material to the other comprehensive income reported in the year. The impact on non current assets and non current liabilities is above our planning materiality which is based on in-year expenditure. However the amounts are <1% of the total for non current assets and liabilities respectively.

Whole of government accounts

We have not yet initiated our audit for Whole of Government (WGA) requirements. We will commence our work on the WGA following approval of the financial statements. Our audit work on WGA for 2020/21 is still outstanding due to HMT delays.

Audit Certificate

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

Independence

We reported separately on our independence to the Audit & Assurance Committee in the papers for this meeting.

Status of the audit

Our audit work in respect of the group opinion is still in progress. The following key matters relating to the completion of our audit procedures were outstanding at the date of this report (these are the main outstandings and is not a comprehensive list all outstanding items):

- Annual Report and accounts - completion of the technical review of the financial statements, including taxation, disclosures review and tie out to underlying audit work for TfL and Crossrail;
- Impairment assessment – completion of TfL and Crossrail impairment assessment review;
- Pensions – EY review of actuarial reports, RSM's audit report of investment fund/asset values, XPS response from the individual members data request and testing of the data.
- Fares revenue – KPMG's ISAE3402 and Agreed Upon Procedures report over contactless ticketing and Oyster pay as you go has not yet been received;
- Valuation of investment property;
- Assessment of going concern and underlying funding arrangement;
- Completion of procurement improvement plan review;
- Climate Risk assessment
- Post balance sheet events up to the date of approval of the financial statements; and
- Receipt of signed letter of representation.

Until the above procedures are completed, we cannot reach our overall conclusion.

02 Areas of Audit Focus

Significant risk and Key Audit Matter

Management override of controls, required by ISA (UK and Ireland) 240

What is the risk?

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.

What judgements are we focused on?

As part of our risk assessment we considered the current objectives of TfL and areas where there might be judgement with potential for bias to present a particular result, such as reduced operating expenditure.

We have assessed management's progress on implementation of action plans during the year in response to the weaknesses identified during FY19/20 audit.

In addition to this the we have assessed the business for impact of continued remote working and transition to hybrid working.

What did we do?

For TfL, TTL group and subsidiaries, we have:

- Robustly challenged management's assumptions on capitalising expenditure as detailed on slide 13;
- Critically reviewed fares revenue as detailed on slide 10;
- Applied professional scepticism by questioning whether management's explanations are logical, reasonable and in line with relevant historic trends supported by sufficient appropriate evidence;
- Reviewed the business rationale for unusual transactions;
- Tested significant transactions that are outside the normal course of business or that appear unusual by agreeing to supporting documentation;
- Performed journal entries testing with specific focus on journals related to cost capitalised indicative of management override (posted by members of management, with blank or unusual descriptions, etc.) with specific focus on top side journals;
- Considered the effectiveness of management's controls designed to address the risk of fraud;
- Understood the oversight given by those charged with governance of management's processes over fraud;
- Tested procurement transactions pre and post action plan implementation to identify any material override of controls;
- From time to time we have matters escalated to us by members of the public. We investigated the matters reported and assessed the impact thereof on our audit risk and audit procedures performed. Any findings identified have been reported to the Audit and Assurance Committee.

What are our conclusions?

With regards to the procedures performed, we have obtained sufficient audit evidence regarding any business rationale for unusual transactions, any assumptions for the capitalisation of expenditure, and for judgements and assumptions for significant estimates.

During FY19/20, weaknesses in procurement process controls were identified by management and internal audit. Management has made progress against the implementation of procurement improvement programme in prior financial year and current financial year. We have completed additional testing and did not identify any material fraud or error. However, the final assessment paper showing the clearance of the recommendations raised is still outstanding from the management and once received we will update our conclusion. Our recommendations for further enhancement of controls will be shared at a later stage in our Management Letter.

Our procedures did not identify any material misstatements in the financial statements. We have reported the impact on our value for money considerations later in this report.

Significant risk and Key Audit Matter

Inappropriate Revenue recognition, required by ISA (UK & Ireland) 240

NOTE – as set out below, the risk is specific to the allocation of fares received based on time periods, services provided by other parties and refunds

What is the risk?

TfL needs to have robust controls in place to forecast and accurately recognise and report revenue in its financial statements.

The significant risk only relates to the fares revenue stream. This is due to the complexity and judgements involved in the process to apportion the fares revenue recognised.

In the public sector, this requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition. We have not identified any specific risk areas in relation to expenditure.

What judgements are we focused on?

Judgements and controls need to be effective to appropriately recognise revenue, these include:

- Fares revenue is recognised on a real time basis at the time of actual usage;
- Calculation and recording of the revenue and deferred revenue based on maturity of the product for fares revenue; and
- Collection of payments made from sales via various sales outlet.

What did we do?

For Fares Revenue, we have:

- Gained an understanding of the revenue process for fares revenue
- Performed controls testing over the effectiveness of the cash collection process and sales made at various sales outlets
- Performed testing to ensure that the Receipts in Advance "RIA" and Journey Facility Ticketing "JFT" Debtor balance is correctly stated
- Tested the appropriateness of assumptions used by management on the oyster write-back policy adopted and the impact of COVID-19
- Recalculated the ageing for a sample of dormant oyster card balances to ensure accuracy
- Tested transactions separately where we are not able to place reliance on the controls in place or where procedures above are not be sufficient
- Tested the fares compensation arrangements with the TOCs resulting from the fares cap introduced in Jan 2015. We further reviewed all settlement differences identified during the year and related communications with TOCs. These were all immaterial both individually and in aggregate, therefore no issues were noted.
- Planned to review ISAE 3402 controls report and the agreed upon procedures report
- Assessed any changes to underlying assumptions used for the recognition of revenue such as TOC apportionment and Oyster Card releases. No inconsistencies noted in apportionment factors throughout FY21/22 and in comparison, to prior year. No significant variances were noted between the apportionment factors quarter on quarter for FY21/22 and year on year in comparison to FY20/21

What are our conclusions?

Our planned procedures in relation to this risk are complete, except for KPMG's testing of controls over contactless ticketing and Oyster pay as you go, set out in their ISAE3402 report and agreed procedures report. This is currently outstanding and we are planning to rely on it.

Once the remaining information is received, we will be in a position to conclude on whether the basis used to recognise fares revenue and related disclosures in the financial statements are reasonable.

We have reviewed the underlying assumptions for Oyster writeback releases to revenue for any changes as travel recovers from the impact of COVID-19. Management has kept the assumptions on Oyster writeback unchanged for FY21/22. The prior year Covid adjustment of £17.5m has been released to the income statement in the current financial year. Management has based the decision on the fact that although travel has significantly improved in current year compared to prior year, the balances on dormant Oyster cards has been increasing as more people have moved to using CPAY contactless payment method as oppose to Oyster PAYG. We have further reviewed the release of the prior year's Covid-19 adjustment of £17.5m back to revenue and analysed the underlying assumptions used by management and concluded they are reasonable.

Significant risk and Key Audit Matter

Going concern, including TfL and Crossrail funding

What is the risk?

There is uncertainty with regards to the going concern assumption for Crossrail and TfL and carrying value of assets, should the funding requirements continue.

Financial statement impact

As reported in the prior year, the Covid-19 pandemic has had a significant impact on TfL's fares income and the availability of funding. In 2021/22, TfL's fares revenue has increased by 97% since the relaxation of Covid-19 restrictions, however the current circumstances continue to present ongoing financial challenges and uncertainty to TfL in predicting the future passenger revenue for the organisation. Therefore, a Fourth Funding and Financing Agreement was agreed by DfT which provides funding for the period 6 February 2022 to 24 June 2022.

As yet there has been no agreement for long-term capital support agreed, although we understand discussions continue between TfL and DfT.

What did we do?

For TfL, TTL groups and subsidiaries, we have:

- Discussed and reviewed the business plan prepared by the management;
- Determined an appropriate strategy to address those identified risks;
- Reviewed the group's revised budget submission Dec-21;
- Reviewed management's assessment of funding requirements and commitments;
- Assessed the impact of funding requirements on TfL projects that could result on the cancellation or delay of major projects;
- Evaluated management's judgements and assumptions used in determining the future benefits expected from the projects and ensuring they are appropriate and supportable;
- Assessed whether any additional obligations exist within the various contractual arrangements that have been omitted from the financial statements;
- Tested the nature of the expenditure incurred to determine if capitalisation is appropriate;
- Obtained an understanding of the group's plans for discontinuation of service and assessed related assets for impairment; and
- Performed additional procedures in response to the continued impact of COVID-19.

Value for money

During the execution of our audit fieldwork for the financial year ended 31 March 2022 we identified a significant weakness as defined by AGN03 with regards to the financial sustainability of TfL, given there is no long term funding arrangement currently in place.

As such we have formally communicated on the weakness identified to the Audit and Assurance Committee. Please refer to Appendix A for a copy of the letter.

Significant risk and Key Audit Matter

What is our conclusion

Although there has been a significant increase in the use of London's transport network since the relaxation of Covid-19 restrictions (e.g. fares revenue increased by 97% as compared to 2020/21), the Government recognised that the current circumstances continues to present ongoing financial challenges and uncertainty to TfL. The Government also recognises that TfL including Crossrail Limited, has existing near and long-term financial commitments and will need to enter new financial arrangements, that extend beyond the funding period. As a result of this, the Government through DfT agreed to issue the Fourth Funding and Financing Agreement which provides funding for the period 6 February 2023 to 24 June 2022.

As part of the Fourth Funding Package, TfL committed to deliver a plan by 31 March 2022 demonstrating the options that exist to achieve up to £400m of additional revenue or cost savings in 2022/23, This was in addition to delivering the previously agreed operating cost savings for the 2021/22 financial year. DfT acknowledged that TfL is facing further cost pressures in 2022/23 and therefore any proposals presented in this plan and the savings level of £400m will be considered and confirmed following a review of TfL's 2022/23 budget.

The Government also stated in the Fourth Funding Package, a willingness in the short and medium term to provide grant funding for renewals and enhancements and to work towards an agreement for long-term capital support with an expectation that this agreement will be reached by 31 March 2022.The Fourth Funding Package included a number of conditions, which includes the continuation and further development of initiatives commenced under previous funding agreements with DfT.

As at the Q4 of 2022, the Group had capital projects in the course of construction totalling £18.7bn (unaudited), of this £14.7bn relates to Crossrail. The remaining balance relates to a range of projects across the network at varying stages of completion.

As part of the Government review of the Group over the past 2 years, a review has been ongoing of the capital programme to identify which projects can and will be funded to completion, including whether projects can be safely paused, whether the costs of termination are more extensive than completing and whether the projects are to ensure the Group meets statutory obligations in respect of safety. It is also possible that during the current discussion with the DfT to agree long-term capital support, that some current services could be deemed as nonessential, which could then lead to an impairment of some assets related to those services. The capital programme includes upgrades and maintenance of current infrastructure and ongoing initiatives for TfL's key priorities in line of the Mayor's Transport Strategy and other Government policies.

At the time of writing this report, there remains uncertainty as to the ongoing funding available from Government in connection with operational funding gap created by lower fares revenue and future capital funding. The current funding agreement expires on 24 June 2022. At the current time this would result in a similar opinion to the year ended 31 March 2021, being a material uncertainty surrounding the funding of the Group and therefore its ability to continue to operate the current level of services, including the planned capital programme post 24 June 2022. We understand that there is likely to be an updated agreement covering operational funding from 24 June 2022 and there may be an agreement on capital funding prior to the financial statement sign off, we will therefore update the position once any funding agreement is agreed for the period post 24 June and share our final conclusions, including our draft audit opinion with the Audit & Assurance Committee for review and discussion prior to Board sign off in July 2022.

Significant risk and Key Audit Matter

Inappropriate capitalisation or potential impairment of capital projects including capital accruals

What is the risk?

TfL, TTL groups and subsidiaries undertake multiple capital projects at any one time, which vary in size, complexity and length of time to complete. In the 2021/22 financial year, TfL's capital expenditure is £1.6bn and of this amount £624m relates to Crossrail projects.

There is a risk of improper capitalisation of cost (through improper calculation of the accruals or improper split between capital and operating expenditure). In addition there is a risk of potential impairment of projects as a result of funding constraints.

What judgements are we focused on?

Judgements and controls need to be effective, to appropriately recognise the costs from these significant projects including:

- Appropriate split of costs between capital and operating expenditure;
- Assessment of the economic useful lives of the asset where costs are capitalised; and
- Whether to recognise impairments and write-offs for assets to reflect increased risks of projects being terminated or suspended.

What did we do?

For TfL, TTL groups and subsidiaries we have:

- Assessed a sample of capital projects (including Crossrail), based on quantitative and qualitative thresholds;
- Understood key controls and governance surrounding capital project accounting and management;
- Tested controls which focused on the effectiveness of the approval process for expenditure and for capitalisation;
- Met with management and project managers virtually during the year and virtually attended management's P13 accruals meetings;
- Critically evaluated management's judgements and assumptions used in determining the future benefits expected from the projects and ensured they are appropriate and supportable;
- Assessed pain/gain arrangements and related accounting treatment. We have validated for any pain and gain elements back to the respective contract (and acknowledgement with contractor as and when a pain/ gain event arises) and made sure that it was correctly reflected in the total value of the project. We are satisfied with the accounting treatment as it is supported by contractual terms.
- Assessed whether or not capitalisation of costs are appropriate in accordance with the contract and relevant accounting guidance (including COVID-19 related costs);
- Considered whether, at any stage, assets need to be impaired or written off to reflect any aborted or higher risk projects;
- Performed detailed testing on a sample of expenditure incurred and capital accruals to source and third party documentation;
- Assessed whether management has reasonably estimated the cost to complete the capital projects;
- Reviewed capital projects to assess progress and potential impairment, in particular, we have assessed the impact of Crossrail progress and funding on the ability of TfL to complete and fund other in-progress projects;
- Reviewed claims and contracts for existence of additional obligations or expenditure that is inappropriate to capitalise;
- Reviewed the accounting and tested COVID-19 payments on projects;
- Reviewed the impairment of projects not included in funding plans. As noted above, there is material uncertainty relating to future funding of capital projects; and
- Performed additional procedures in response to the continued impact of COVID-19 where appropriate.

What are our conclusions?

Procedures have been completed for TfL and TTL groups with no material issues, with the exception of understanding the availability for future funding for projects in-progress at the balance sheet date. We are satisfied that the capitalised costs in the year meet the criteria for capitalisation and are appropriate. We concur with the impairment of projects not included in funding plans in the pre-COVID-19 business plan.

We noted costs were incurred as a result of COVID-19. We are still to complete and conclude our review of COVID-19 costs expensed in the current year.

An initial review was performed to identify non-essential projects that no longer align to TfL's priorities. As a result, assets (Cost capitalised) for projects abandoned have been written off in the current year amount to £16.7m. Projects where assets could potentially be reused on a different project has been treated as an impairment loss in the current year. The impairment loss amounted to £51.4m.

We are currently awaiting management's assessment on the categorisation of all projects at the balance sheet date. Once received we will review and communicate our results from the procedures performed.

We also understand that a capital funding agreement may be reached with the Government prior to the final approval of the financial statements. Management will then need to re-assess the position of in progress projects to determine whether these are included in future capital funding to completion and to re-assess the risk of impairment. We still have procedures to complete to conclude on going concern as detailed on slide 11 and 12. We will therefore update the position once any funding agreement is agreed for capital and share our final conclusions, including our draft audit opinion with the Audit & Assurance Committee for review and discussion prior to Board sign off in July.

Significant risk and Key Audit Matter

Complexity of accounting for TfL and TTL property portfolios

What is the risk?

TfL and TTL groups have extensive property portfolios, with a total book value for property of £1.7bn as at 31 March 2022 (of which £160.1m was Assets Held for Sale). Included within the portfolios are office buildings and investment properties.

The unique and material nature of TfL and TTL group's property portfolios means that small changes in assumptions when valuing these assets can have a material impact on the financial statements.

TfL will need to comply with the Mayor's housing programme. The Mayor has committed to prioritising affordable home delivery on surplus or under utilised owned by the GLA Group, including TfL. This might have a negative impact on the valuation of TfL's property portfolio.

In the prior year, as part of the Group's commercialisation strategy, the Group consolidated properties available for non-operational use in a new subsidiary entity. This resulted in a change in use from 'owner-occupied' to newly separable investment property assets. This could result in inappropriate classification of assets and presentation of revaluation changes.

Further, with the continued impact of COVID-19 pandemic on the market conditions and growing uncertainty around valuation, the fair value assessment of property portfolio is also changing.

What did we do?

For TfL, TTL groups and subsidiaries, we have planned to:

- Discuss with management and review evidence to gain understanding of TfL and TTL group's property portfolios;
- Discuss and review valuation assumptions and methodology applied by external valuers along with the TfL property team;
- Perform substantive testing and corroborate explanations for property additions, disposals and accounting for lease contracts;
- Review the valuations report prepared by TfL's external valuers, agreeing the entries in the report back to the financial statements to confirm the accuracy of the entries;
- Assess the classification of TfL and TTL property portfolios, the valuation basis and any material increases or impairments that had occurred during 2021/22;
- Assess the work of TfL's property valuers. We have used our EY property valuation team as appropriate to assist in our review of whether TfL's key assumptions are within an acceptable range based on comparative market data for rental yields;
- Review the accounting treatment of valuation movements for non-core assets and ensured it is appropriately disclosed;
- Review infrastructure and office buildings, PFI accounting models and appropriateness of accounting and disclosures;
- Consider classification of assets between investment properties, property, plant and equipment and assets held for sales in accordance with IFRS;
- Review sites to ensure affordable housing density needs are appropriately built into site valuations; and
- Perform additional procedures in response to the continued impact of COVID-19.

What judgements are we focused on?

Judgements and controls need to be effective, to appropriately recognise the carrying value of assets including:

- Identifying and relying on significant assumptions used by external valuers;
- Reviewing and understanding methodology used to assess the property valuation;
- Reviewing the observable market data for the properties portfolio selected for valuation by external valuers; and
- Appropriately classifying assets between operational and investment.

What are our conclusions?

We are in the process of completing our procedures and have not yet concluded that property valuations were within an acceptable range.

We are still to receive the final valuation report from CBRE to enable us to conclude on whether the disclosure set out in the notes to the financial statements provides users with an appropriate explanation of this matter.

Other areas of audit focus

Other areas of audit focus

Judgemental assumptions impacting TfL's pension deficit

At 31 March 2022, TfL's defined benefit pension schemes had a deficit of £3,201.5m (2021: £5,603m). The Group's balance sheet reflects the deficit on the TfL defined benefit pension scheme, TfL's share of the deficit on the Local Government Pension Scheme, the deficit on the Crossrail section of the Railways Pension Scheme and the liability for unfunded pensions obligations.

Audit of pension scheme assets requires particular care given the current market volatility. There is a risk of potential short to medium term impact of COVID-19 on the net pension liability.

The assumptions used to arrive at the value of the pension deficit are judgemental. The setting of these assumptions should be in accordance with IAS19(R) Employment Benefits.

Any update to the financial assumptions should be supported by management in the context of the business plans and general outlook. In particular, we expect short to medium term impacts of COVID-19 to be balanced against the long-term nature of the changes in financial assumptions.

IAS 19 reports have been received from the actuaries. The review is still in progress at the date of this report.

Leases (IFRS 16)

IFRS 16 was adopted for the first time in the 31 March 2020 financial statements. It requires entities to recognise a right of use asset and corresponding lease liability in its Statement of Financial Position.

Further, there is a risk of potential impairments of the IFRS16 assets as a result of the impact of COVID-19.
When applying IFRS16 there are a number of judgements and estimates to be taken by management including:

- Determining the interest rate to be used in the calculation of lease liabilities - Management has continued utilising the same rate from the date of IFRS16 adoption for all deliveries of rolling stock in the 2021/22 financial year end accounts.
- Assessing the length of leases - in particular with respect to station and track access.
- Assessing the value of 'peppercorn' leases – the CIPFA Code requires the recognition of values related to peppercorn leases (this is not required under adopted IFRS).
- Calculating an estimate of costs relating to bus contracts – management uses the same allocation across the whole fleet of contracts, based on contracts in place. As the proportion for non-diesel vehicles increases the cost allocation may change.

Determining the interest rate to be used in the calculation of lease liabilities – management has utilised the same rate from the date of IFRS16 adoption for all deliveries of rolling stock in the year. Our view, as reported in the prior year, is that the rate should be determined at each delivery date for each batch of units, using management's rates to recalculate the accounting, gives rise to a cumulative judgemental difference of £50m (20/21: £37m) higher value for right of use asset and £41m (20/21: £32m) for the related lease liability in the 2021/22 accounts. We would expect the fluctuations to occur until all rolling stock has been received. The impact on the total right of use asset and lease liability is not in a material percentage and the impact on the Comprehensive Income and Expenditure for the year is also is not material.

Other areas of audit focus - continued

Other areas of audit focus

Significant accounting estimates – including complexity of provisions

Certain provisions (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 capital contract and commercial arrangements. A large proportion of TfL's provisions come from its compensating and contractual (£70.4m) and capital investment activities (£58.5m).

In particular CPO provisions and contractual disputes are subject to significant estimation and include uncertainty around negotiations. We also note that there are some legal proceedings against TfL for which provisions have been recorded. Potential exposure including compensation for new claims assessed all immaterial both individually and in aggregate, therefore no issues were noted.

For TfL, TTL groups and subsidiaries we have:

- Ensured provision balances meet the recognition criteria under IAS37.
- Reviewed and critically evaluated management's judgement and estimates applied in the calculation of provisions in the financial statements.
- Performed a retrospective review to assess the accuracy of provisioning and any evidence of management bias.
- For completeness, performed unrecorded liabilities testing, minute review etc.

We have completed our audit procedures with no material issues. We are satisfied that the provisions made are within an acceptable range, based on the latest available information.

Other accounting estimates

There has been a provision recognised for senior management performance award of £10.7m and other performance award arrangement of £7.5m. On discussion with management the amount provided reflects staff performance in the year, however due to the current financial restraints the amount will not be paid until 23/24. Within the current funding agreement, clause 16, it states 'Any bonus pay awards will not be paid for through the extraordinary Government funding and TfL will demonstrate prudence in making any such payments. We do not expect TfL to authorise individual bonus pay awards.'

We have challenged management as to whether the provision for the performance award in the current year complies with the funding agreement and whether DfT is aware of these amounts provided. Management has confirmed that when considering this performance award the condition in the agreement (clause 16) has been taken into account and hence the delay in pay out of the amounts until 23/24 when it is expected that Government funding will have ceased. Management has also confirmed that the DfT is aware of this performance award, but noted that the DfT has not explicitly confirmed that they are satisfied that it does not contravene the funding agreement clause.

The value itself is not material in the context of planning materiality for the audit, however this is a sensitive matter and we recommend that management obtain explicit approval from the DfT that the payment of this aware in future years, but relating to, and accounted for in a year in which Government funding was received.

Other areas of audit focus

Other areas of audit focus

Climate related risks

In response to increasing concerns about the impacts of climate change on the economy and financial stability, the FRC is calling for organisations to be more transparent on how they are addressing climate risk. Whilst reporting, in itself, cannot limit the effect of climate change, transparency of how organisations are responding to this risk provides stakeholders with better information and may guide how they interact with an organisation: whether it is funders deciding whether to fund; employees deciding which organisations they would like to work for; customers deciding which services to use; or suppliers deciding which organisations to sell their products/services to.

As a result we will perform the following audit procedures:

- Obtain an understanding of the Group's climate risk assessment;
- Review the accuracy and completeness of the climate risk assessment;
- Review substantive evidence supporting climate-related disclosures made in the Annual Report; and
- Review climate-related narrative in the Annual Report; and
- Engage with our EY Specialists team to perform an independent review of the consistency of the Climate risk narrative disclosures with the financial statements and the relevance to the financial audit.

Overview of Climate risks reporting through the TCFD Framework on TfL

Due to the nature of the services that TfL provides, a broad range of stakeholders are demanding transparency on climate risks. TfL operates to deliver the Mayor Transport Strategy (MTS) and plays a crucial role in delivering other Mayoral strategies and plans. Ensuring alignment with national and mayoral targets (such as carbon neutrality for London by 2030) will require significant financial investment.

The Task Force on Climate-related Financial Disclosures ('TCFD') Framework was established to promote consistent climate-related financial risk disclosures for use by companies, financial institutions, and investors. It is structured in four thematic areas – Governance, Strategy, Risk management, and Metrics and targets - with eleven voluntary recommendations of what to include in financial disclosures.

For TfL, reporting against the TCFD framework should be more than just about compliance with regulation. Climate risks pose a range of credible business risks that will have significant financial implications over the coming years. Building on work already done through its Adaptation Report, TfL should use the TCFD framework to better understand climate risk exposures and develop approaches to actively quantify their potential financial impacts. This will support the development of appropriate steps to mitigate the worst impacts of climate change and establish essential and sustainable financial planning.

TfL has already taken key steps towards improved climate risk disclosures, in line with the TCFD recommendations. TfL's Corporate Environment Plan (CEP) and sustainability reports have identified climate change as a key priority for TfL and have set out various ambitions and roadmaps on how to achieve them. TfL's voluntary reporting against the Adaptation Reporting Power has included assessing the assets against climate risks was published in February 2022. TfL has also done work integrating climate risks into overall risk management, and raising the profile of climate change internally, such as through the work of the SHE Corporate Environment and City Planning teams.

There are still, however, some important considerations and next steps that TfL will need to focus on to lay the foundation for good practice TCFD reporting. This is particularly important in the context of everchanging ambitions and requirements at national and mayoral level, as evidenced by the recent announcement by UK Chancellor Rishi Sunak, who announced the ambition for UK to become the first 'Net Zero Aligned Financial Centre' at COP26 in November 2021, making it mandatory for firms to publish clear, deliverable plans to align with net zero. The core strategy of TfL's business will be increasingly impacted by climate change. In order to support core strategic decisions TfL must develop a clear understanding of what the risks are and how they will impact the business financially.

The review of the climate-related narrative and review of substantive evidence supporting climate-related disclosures are in progress at the time of writing this report.

03 Value for Money Risks

Value for money

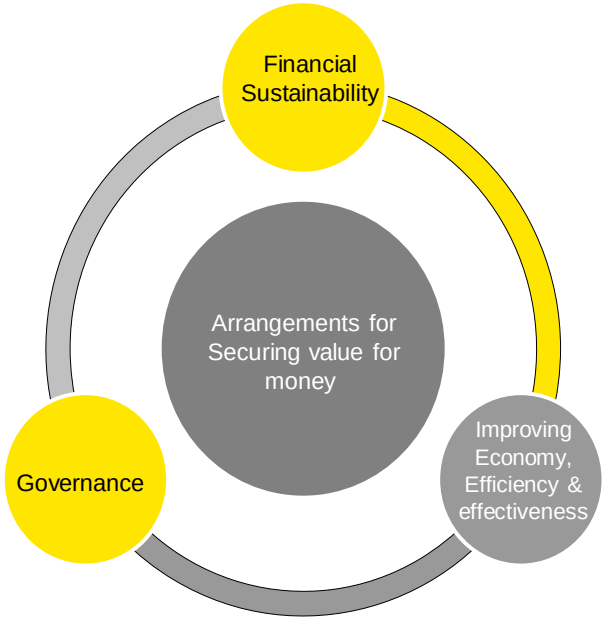
Background

We are required to consider whether the Authority has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources.

For 2021/22, proper arrangements are defined by 2020 statutory guidance issued by the National Audit Office on 1 April 2020, as:

- Financial sustainability: how the body plans and manages its resources to ensure it can continue to deliver its services;
- Governance: how the body ensures that it makes informed decisions and properly manages its risks; and
- Improving economy, efficiency and effectiveness: how the body uses information about its costs and performance to improve the way it manages and delivers its services.

In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.



Exception reporting on TfL's VfM arrangements

We are only required to determine whether there are any risks that we consider significant within the Code of Audit Practice, where risk is defined as:

"A matter is significant if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public".

Our risk assessment supports the planning of enough work to deliver a safe conclusion on your arrangements to secure value for money, and enables us to determine the nature and extent of any further work needed. If we do not identify a significant risk we do not need to carry out further work.

Based on the work we performed, we have concluded that there are arrangements in place to secure economy, efficiency and effectiveness, except in relation to two areas:

- The uncertainty with regards to a long-term funding agreement and impact thereof on planning and resource management to maintain service delivery; and
- An action plan was put in place to address the weaknesses identified, however our assessment of implementation of procurement improvement programme still in progress.

Value for Money Risks

Significant weaknesses in arrangements	What did we do?
Financial sustainability: How the body plans and manages its resources to ensure it can continue to deliver its services	TfL is responsible for the critical day-to-day operation of London's transport system and also has a significant capital programme to create Crossrail and various other enhancements to the network, as well as to improve safety and commercialise its assets to generate additional non passenger/grant income in future years. Without continuous, stable investment to operate and maintain TfL's existing network and ensure it keeps pace with societal expectations, its performance will decline. This will mean fewer people using public transport to travel around London and more people using cars, resulting in increased pollution and congestion. In turn this will have a negative impact on the attractiveness of the City and will negatively impact the local economy. Without a longer-term funding agreement in place, TfL is making short term decisions based on the current funding arrangements. If longer-term funding arrangements were in place, management would be able to make more robust decisions, negotiate better long-term deals with suppliers or contractors and identify synergies and cost saving opportunities. This means that TfL is not obtaining the best value for money due to lack of clarity of long-term funding agreements going forward. As such, we have identified a significant weakness with regards to how TfL plans and manages its resources to ensure it can continue service delivery. <u>EY Recommendation:</u> Whilst agreeing long term funding packages is extremely challenging in the post pandemic world with many conflicting funding demands on government funding, without an agreed long-term plan TFL will continue to have to make suboptimal decisions and spend significant management time continually reprioritising. Therefore, it is fundamental to the ability of management to appropriately exercise their responsibilities and enable TfL to fulfil its strategic priorities and facilitate Government policies for London, that a longer-term funding plan is agreed. We recommend that management agree a long term plan as quickly as possible, even if that funding is less than might be desirable in order to allow that funding to achieve value for money. Clearly if compromising on funding, we also recommend that the consequences of the funding package are also made clear to enable prioritisation versus other competing demands. In line with the Code of Audit Practice, we have reported significant weaknesses identified during the execution of our audit procedures. Please refer to Appendix A for a copy of the letter issued to the Audit and Assurance Committee.

Value for Money Risks

Significant weaknesses in arrangements	What did we do?
Improving economy, efficiency and effectiveness: How the body uses information about its costs and performance to improve the way it manages and delivers services	During 2019/20 Transport for London identified a series of weaknesses with the application of procurement rules throughout the organisation. Procurement arrangements were not being followed in all cases, leading to a significant amount of single source tender arrangements and other contracting arrangements that may not have provided value for money. An action plan was put in place to address the weaknesses identified, however it was not effective for the full financial year 2020/21 due to the impact of COVID-19 resulting in the need to prioritise exceptional protocols during the pandemic, rather than business as usual changes from the existing action plan. At the time of writing this report, our work in relation to procurement and review whether improvement programme were implemented are still in progress and we will update the Audit & Assurance Committee on further progress once we conclude on the matter.

04 Audit Differences

Audit Differences

Summary of unadjusted differences

In addition we highlight the following misstatements to the financial statements and/or disclosures which were not corrected by management. We request that these uncorrected misstatements be corrected or a rationale as to why they are not corrected be considered and approved by the Audit & Assurance Committee and provided within the Letter of Representation:

Uncorrected misstatements 2021 (£million)	Effect on the current period:		Net assets (Decrease)/Increase				Impact on reserves
		Total comprehensive income Debit/(Credit)	Assets current Debit/ (Credit)	Assets non current Debit/ (Credit)	Liabilities current Debit/ (Credit)	Liabilities non-current Debit/ (Credit)	Impact on brought forward reserves
Errors:							
Judgemental differences:							
• IFRS16 – rolling stock – rate used at each delivery date		(5)		50		(41)	(5)
Impact of difference arising in prior year:							
• Difference in accounting for certain contract incentive payments*		2		47			(49)
Total effect of uncorrected misstatements (before tax)		*(3)*		*97*		*(41)*	*(54)*
Less: tax effect at current year marginal rate		(0)					
Cumulative effect of uncorrected misstatements before turnaround effect		(3)					
Turnaround effect of prior year uncorrected misstatements		0					
Cumulative effect of uncorrected misstatements, after turnaround effect		(3)					

There are no amounts that we identified that are individually or in aggregate material to the other comprehensive income reported in the year.
The impact on non current assets is above our planning materiality which is based on in-year expenditure. However the amounts are < 1% of the total for non current assets.

- This difference was identified in the prior year audit and arises in the accounting for payments made between 2013 and 2018 on a specific contract – our view is that these should have been capitalised and depreciated over the asset life.

Please note, this is not the final list of all misstatements as our audit is ongoing.

5 Appendices

Interim VFM reporting to the Audit and Assurance Committee Meeting

Appendix B

Required communications with the Audit & Assurance Committee

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

		Our Reporting to you
Required communications	What is reported?	When and where
Terms of engagement	Confirmation by the audit & assurance committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	Discussed within PSAA terms of appointment for TfL and our engagement letter for the subsidiary entities
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter.	Discussed within Planning report presented to the Audit and Assurance Committee on 1 December 2021
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified. When communicating key audit matters this includes the most significant risks of material misstatement (whether or not due to fraud) including those that have the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team.	Discussed within Planning report
Significant findings from the audit	• Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures • Significant difficulties, if any, encountered during the audit • Significant matters, if any, arising from the audit that were discussed with management • Written representations that we are seeking • Expected modifications to the audit report • Other matters if any, significant to the oversight of the financial reporting process	Discussed within this report

Appendix B

		Our Reporting to you
Required communications	What is reported?	When and where
Major Local Audits	For the audits of financial statements of major local audits our written communications to the Audit and Accounts Committee include: • A declaration of independence • The identity of each key audit partner • The use of non-member firms or external specialists and confirmation of their independence • The nature and frequency of communications • A description of the scope and timing of the audit • Which categories of the balance sheet have been tested substantively or controls based and explanations for significant changes to the prior year, including first year audits • Materiality • Any going concern issues identified • Any significant deficiencies in internal control identified and whether they have been resolved by management • Subject to compliance with regulations, any actual or suspected non-compliance with laws and regulations identified relevant to the Audit and Accounts Committee • Subject to compliance with regulations, any suspicions that irregularities, including fraud with regard to the financial statements, may occur or have occurred, and the implications thereof • The valuation methods used and any changes to these including first year audits • The scope of consolidation and exclusion criteria if any and whether in accordance with the reporting framework • The completeness of documentation and explanations received • Any significant difficulties encountered in the course of the audit • Any significant matters discussed with management • Any other matters considered significant	We are concluding our work on this area and will update the Accounts & Audit committee once this work is completed.
Subsequent events	• Enquiry of the audit committee where appropriate regarding whether any subsequent events have occurred that might affect the financial statements.	We are concluding our work on this area and will update the Accounts & Audit committee once this work is completed.

Appendix B

		Our Reporting to you
Required communications	What is reported?	When and where
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 related to going concern • Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements • The appropriateness of related disclosures in the financial statements	Discussed within this report
Misstatements	• Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation • The effect of uncorrected misstatements related to prior periods • A request that any uncorrected misstatement be corrected • Material misstatements corrected by management	Discussed within this report. As we finalise our review of the financial statements, any disclosure misstatements may need be included on our Disclosure Summary of Audit Differences. We will update the Accounts & Audit committee once this work is completed.
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 • Unless all of those charged with governance are involved in managing the entity, any identified or suspected fraud involving: a. Management; b. Employees who have significant roles in internal control; or c. Others where the fraud results in a material misstatement in the financial statements. • The nature, timing and extent of audit procedures necessary to complete the audit when fraud involving management is suspected • Any other matters related to fraud, relevant to Audit Committee responsibility.	Discussed within this report
Related parties	Significant matters arising during the audit in connection with the entity's related parties including, when applicable: • Non-disclosure by management • Inappropriate authorisation and approval of transactions • Disagreement over disclosures • Non-compliance with laws and regulations • Difficulty in identifying the party that ultimately controls the entity	We are concluding our work on this area and will update the Accounts & Audit committee once this work is completed.

Appendix B

		Our Reporting to you
Required communications	What is reported?	When and where
Independence	Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, 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 Communications whenever significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place. For public interest entities and listed companies, communication of minimum requirements as detailed in the FRC Revised Ethical Standard 2019: • Relationships between EY, the company and senior management, its affiliates and its connected parties • 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 Standard, including any non-EY firms or external experts used in the audit • Details of any inconsistencies between the Ethical Standard and Group's policy for the provision of non-audit services, and any apparent breach of that policy • Where EY has determined it is appropriate to apply more restrictive rules than permitted under the Ethical Standard • The audit committee should also be provided an opportunity to discuss matters affecting auditor independence	These matters are included within this report and also included within the Planning Audit Report for the year ending 31 March 2022 and our separate independence report

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		Our Reporting to you
Required communications	What is reported?	When and where
External confirmations	• Management's refusal for us to request confirmations • Inability to obtain relevant and reliable audit evidence from other procedures.	We are concluding our work on this area and will update the Accounts & Audit committee once this work is completed.
Consideration of laws and regulations	• Subject to compliance with applicable regulations, matters involving identified or suspected non-compliance with laws and regulations, other than those which are clearly inconsequential and the implications thereof. Instances of suspected non-compliance may also include those that are brought to our attention that are expected to occur imminently or for which there is reason to believe that they may occur • 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	We are concluding our work on this area and will update the Accounts & Audit committee once this work is completed.

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		Our Reporting to you
Required communications	What is reported?	When and where
Significant deficiencies in internal controls identified during the audit	• Significant deficiencies in internal controls identified during the audit.	Discussed within this report and within the Management Letter report
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.	We are concluding our work on this area and will update the Accounts & Audit committee once this work is completed.
Written representations we are requesting from management and/or those charged with governance	• Written representations we are requesting from management and/or those charged with governance	We are concluding our work on this area and will update the Accounts & Audit committee once this work is completed.
Material inconsistencies and/or misstatements	• Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Discussed within this report
Auditors report	• Key audit matters that we will include in our auditor's report • Any circumstances identified that affect the form and content of our auditor's report	We are concluding our work on this area and will update the Accounts & Audit committee once this work is completed.

Appendix C

Outstanding matters

The following items relating to the completion of our audit procedures are outstanding at the date of the release of this report:

Item	Actions to resolve	Responsibility
Annual Report and accounts	Work on underlying statutory accounts, taxation and disclosures has commenced.	EY and Management
Impairment assessment	Awaiting management assessment of impairment for TfL and Crossrail	EY and Management
Fares Revenue	Awaiting KPMG's ISAE 3402 and Agreed Upon Procedures report over contactless ticketing and Oyster pay as you go	EY and Management
Investment Properties	Awaiting final valuation report from CBRE and testing of valuations is ongoing	EY and Management
Value for Money	Awaiting updated report on implementation of the Procurements and Supply Chain Improvement Programme (PSCIP)	EY and Management
Pensions – review of actuarial assumptions	Actuarial reports have been received. EY pension team is working on the review of the assumptions used	EY and Management
Assessment of going concern and underlying funding arrangement	Awaiting management assessment on the funding required for the Crossrail Project. EY will assess the assumptions and the reasonableness of this assessment.	EY and Management
Climate Risk assessment	We are still to review the final disclosures	EY and Management
Post balance sheet events up to the date of approval of the financial statements	Post balance sheet event review will be performed through to the signing of the Financial Statements	EY and Management
Signed letter of representation	Draft representation letter will be shared with management separately	EY and Management

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