Independent auditor's report to the members of National Express Group PLC

Opinion on Financial Statements of National Express Group PLC

In our opinion:
- the Financial Statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 December 2016 and of the Group's and the parent Company's profit for the year then ended;
- the Group Financial Statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the parent Company Financial Statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including FRS 101 "Reduced Disclosure Framework"; and
- the Financial Statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group Financial Statements, Article 4 of the IAS Regulation.

The Financial Statements that we have audited comprise:
- the Group Income Statement;
- the Group Statement of Comprehensive Income;
- the Group and parent Company Balance Sheets;
- the Group Cash Flow Statement;
- the Group and parent Company Statements of Changes in Equity;
- the related notes 1 to 39 for the Group Financial Statements; and
- the related notes 1 to 19 for the parent Company Financial Statements.

The financial reporting framework that has been applied in the preparation of the Group Financial Statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent Company Financial Statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 101 "Reduced Disclosure Framework".

Summary of our audit approach

Key risks	The key risks that we identified in the current year were: • Goodwill and fixed asset impairment; • North American insurance and other claims provisions; • Pensions accounting; and • Fuel hedge accounting.
Materiality	The materiality that we used in the current year was £8.9 million which was determined on the basis of normalised profit before tax, including the impact of the UK Rail division which was reported as a discontinued operation in the current year due to the post year-end sale of NXET. Materiality represents 5.1% of this profit metric.
Scoping	• Full scope audit work was completed on a divisional sub-consolidation basis for Rail, UK Bus, UK Coach, North America, and Spain and Morocco. • Specified audit procedures have been performed over certain revenue and cost balances within the Bahrain joint venture. • Full scope audit procedures have been performed on the parent Company Financial Statements. • All other parts of the Group have been subject to analytical review procedures. • The five operating divisions and the Group head office function contributed 100% (2015: 100%) of Group revenue and Group operating profit and 99% (2015: 99%) of Group net assets
Significant changes in our approach	We have not reported on 'tax provisions' as a key audit risk in the current year. This is a result of the level of associated risk having reduced significantly following the closure of a number of ongoing tax enquiries.

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Going concern and the directors' assessment of the principal risks that would threaten the solvency or liquidity of the Group
As required by the Listing Rules we have reviewed the directors' statement regarding the appropriateness of the going concern basis of accounting contained within note 2 to the Financial Statements and the directors' statement on the longer-term viability of the Group contained within the Group Finance Director's Review on page 45.

We are required to state whether we have anything material to add or draw attention to in relation to:

- the Directors' confirmation on page 34 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity;
- the disclosures on pages 36-37 that describe those risks and explain how they are being managed or mitigated;
- the Directors' statement in note 2 to the Financial Statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's ability to continue to do so over a period of at least twelve months from the date of approval of the Financial Statements; and
- the Directors' explanation on page 45 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We confirm that we have nothing material to add or draw attention to in respect of these matters.

We agreed with the Directors' adoption of the going concern basis of accounting and we did not identify any such material uncertainties. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

Independence
We are required to comply with the Financial Reporting Council's Ethical Standards for Auditors and confirm that we are independent of the Group and we have fulfilled our other ethical responsibilities in accordance with those standards.

We confirm that we are independent of the Group and we have fulfilled our other ethical responsibilities in accordance with those standards. We also confirm we have not provided any of the prohibited non-audit services referred to in those standards.

Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team.

Risk description	How the scope of our audit responded to the risk	Key observations
Goodwill and other non-current asset impairment Total goodwill, intangible assets and property, plant and equipment at 31 December 2016 were £2,532.2 million. The most significant balances relate to the Spain and Morocco division (£1,127.9 million) and the North America division (£1,163.0 million). There is a risk surrounding the recoverability of these balances, as assessed annually by management as part of their goodwill impairment review using discounted cash flows on a value in use basis. The key judgements in assessing goodwill and other non-current assets for impairment are the discount rate and the perpetual growth rate used. The value in use models are highly sensitive to changes in these rates, both of which must reflect a long-term view of underlying growth in each respective economy. We note that estimating a value in use is inherently judgemental, and a range of assumptions can reasonably be applied in determining an appropriate discount rate and perpetual growth rate to use. The Audit Committee Report on page 79 refers to goodwill and fixed asset impairment as a key judgement considered by the Audit Committee. Note 2 to the Financial Statements sets out the Group's accounting policy for testing goodwill for impairment. The basis for the impairment reviews is outlined in note 14 to the Financial Statements, including details of the pre-tax discount rate and terminal growth rate used. Note 14 to the Financial Statements also includes details of the extent to which the goodwill and fixed asset impairment test is sensitive to changes in the key inputs.	Our procedures for challenging management's methodology and assumptions focussed on the Group's interests in Spain (and Morocco) and North America and included: • assessing the appropriateness of any changes to assumptions since the prior period; • validating the integrity of the impairment models through testing of the mechanical accuracy and verifying the application of the input assumptions; • understanding the underlying process used to determine the risk adjusted cash flow projections; • challenging the cash flow forecasts with reference to historical forecasts, actual performance and independent evidence to support any significant expected future changes to the business; • working with our valuation specialists to benchmark the discount rates and perpetuity growth rates applied to external macro-economic and market data. This involved consideration of the impact of territory-specific risk-adjustments to the discount rate and perpetuity growth rates versus the risk adjustments made to the underlying cash flows; and • assessing the appropriateness of the disclosures included in the Financial Statements including the sensitivity analysis provided.	We determined that there is currently sufficient headroom for both the Spain and Morocco division and the North America division such that we concur with management that no impairment is required. Whilst we note that both businesses are reliant on the long-term economic performance of their respective territories, we conclude that the assumptions applied in the impairment models, when taken in aggregate, are within our acceptable range.

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Risk description	How the scope of our audit responded to the risk	Key observations
North American insurance and other claims provisions Of the total Group claims provision of £113.6 million at 31 December 2016, £105.4 million relates to the North America division. This reflects historical claims being managed by the Group, as well as provision for new claims identified in the year, including amounts arising through acquisition in the year that have required separate fair value consideration. Estimation of insurance and other claims provisions, including those arising on acquisition, is highly judgemental and is based on assessment of the expected settlement of known claims together with an estimate of settlements that will be made in respect of incidents incurred but not reported at the balance sheet date. The measurement of the self-insured claims provision in North America uses a combination of actuarial assumptions around loss development and management judgement to ensure that the Group is appropriately provided. Given the level of complexity and judgement involved in making these estimations there is a risk the eventual outcome is materially different from that estimated and provided for. The Audit Committee Report on page 79 refers to North American insurance and other claims provisions as a key judgement considered by the Audit Committee. This area has also been highlighted as a key accounting estimate and judgement in note 2 to the Financial Statements. Details of the Group claims provision are given in note 26 to the Financial Statements.	We used our actuarial specialists to challenge the assumptions inherent in the valuation produced by the Group's Actuary in North America for the high volume lower value claims, such as the loss development factors and ultimate expected losses, and to re-perform the actuarial calculation to develop a valuation range. For the individually large claims not subject to actuarial review, we discussed the nature of each claim with the US General Counsel and those responsible for claims handling and tested a sample of items to independent evidence to assess the expected range of possible outcomes. This included testing the fair value of provisions recognised on acquisitions during the year. We compared the overall level of provision recorded to the range determined by management and the Group's Actuary, to conclude whether the level of provision was appropriate. This involved consideration of the audit evidence supporting the range as well as the independent assessment of the range for higher volume lower value claims produced by our actuarial specialists.	As part of our detailed audit work testing the various aspects of the provision, including new amounts recognised at fair value on acquisition and the income statement charge for the year, we did not identify any material exceptions. When considering the overall balance sheet provision in light of the wide range of the potential outcomes, and having taken into account the results of our audit work, we consider that the provision for North American insurance and other claims falls within our acceptable range.

Risk description	How the scope of our audit responded to the risk	Key observations
Pensions accounting The Group's overall net pension liability across all schemes (including that held within National Express Essex Thameside ("NXET") as shown separately within the group of assets available for sale) is £50.5 million at 31 December 2016. The measurement of the Group's gross defined benefit obligation (including that held within NXET) of £848.1 million under IAS 19 Employee Benefits requires management to make judgements on assumptions including price inflation, discount rates, pension increase, mortality rates and earnings growth. A change in any one of these assumptions could have a material impact on the determination of the gross defined benefit obligation. The triennial funding valuation for the Group's principal UK Bus scheme is in the process of being finalised for the year to 31 December 2016. The triennial funding valuation of the principal Group scheme has been completed for the year to 31 December 2016. The recognition of scheme surpluses requires judgement around the application of IFRIC 14 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction. Total accounting surpluses recognised by the Group at 31 December 2016 total £82.2 million, including an amount of £37.7 million for NXET. The Audit Committee Report on page 79 refers to pensions accounting as a key judgement considered by the Audit Committee. This area has also been highlighted as a key accounting estimate and judgement in note 2 to the Financial Statements. Details of the Group's pension obligations are outlined in note 34 to the Financial Statements. The surplus recognised on the NXET scheme is disclosed separate in note 11 as this scheme was part of a business treated as 'held for sale' at year-end.	We challenged the actuarial assumptions used to calculate the gross defined benefit obligation and our actuarial specialists performed a critical assessment of the key assumptions with reference to comparable market data. We also tested a sample of the data used in the actuarial valuation, as well as assessing the basis on which pension surpluses were recognised. The latter involved agreeing related terms to the deeds of the relevant Group pension scheme and considering the impact of rail franchise adjustments on the NXET scheme.	From the audit work completed we are satisfied that the methodology and assumptions applied in relation to determining the pension valuation, when taken in aggregate, fall within an acceptable range.
Fuel hedge accounting The Group's non-rail divisions consume approximately 225 million litres of fuel each year for which it is at risk of price changes. It is the Group's policy to hedge fuel price fluctuations in order to provide short to medium term cost certainty. At 31 December 2016 the Group held fuel derivatives with an overall net fair value of £13.1 million, comprising liabilities of £25.3 million offset by assets of £12.2 million. Accounting for fuel commodity contracts is an inherently complex area and the existence of a number of factors, such as basis risk, means judgement is applied in testing the accounting hedges for effectiveness. The Audit Committee Report on page 79 refers to fuel hedge accounting as a key judgement considered by the Audit Committee. The Group's accounting policy for fuel hedges is outlined in note 2 to the Financial Statements. Note 31 to the Financial Statements outlines details of the fair value of the fuel hedge derivatives at year-end.	We have worked with our treasury accounting specialists to: • challenge the valuations of a sample of forward fuel hedge contracts by calculating independent fair values; • review the hedge documentation with reference to the requirements of IAS 39 and best practice; • completed independent effectiveness testing for a sample of hedges; and • challenged the Group's assessment of the highly probable assumptions in respect of the forecast transactions.	Our independent testing of the fair value of the fuel hedge derivatives did not identify any material valuation differences and in aggregate the fair value of the fuel hedge derivatives, which are provided to the company by the relevant financial institution counterparties, were deemed to be appropriate. The results of our audit work assessing the Group's application of hedge accounting identified no material deviation from the requirements of IAS 39 Financial Instruments: Recognition and Measurement.

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These matters were addressed in the context of our audit of the Financial Statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Our application of materiality
We define materiality as the magnitude of misstatement in the Financial Statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the Financial Statements as a whole as follows:

Group materiality	£8.9 million (2015: £8.0 million)
Basis for determining materiality	5.1% (2015: 5.3%) of normalised profit before tax, including the impact of the UK Rail division which was reported as a discontinued operation in the current year due to the post year-end sale of NXET. Normalised profit before tax is disclosed on the face of the Group Income Statement where it is reconciled to statutory profit before tax. Note 11 to the Financial Statements outlines profit before tax of £4.9 million for discontinued operations.
Rationale for the benchmark applied	Normalised profit is one of the key metrics used both externally and internally as excluding exceptional items, although there are none in 2016, which are volatile, as well as amortisation costs, facilitates a better understanding of the underlying trading performance. The results of NXET were included to reflect the basis on which the Group’s consensus normalised profit before tax had been set for 2016. This materiality level equates to less than 1% of equity.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £300,000 (2015: £160,000), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the Financial Statements.

An overview of the scope of our audit

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level. Based on that assessment, as in the prior year, we focused our Group audit scope primarily on the audit work at the five operating divisions and the Group head office function. Each operating division produces its own sub-consolidation and was subject to an audit that was scoped relevant to its component materiality level, which was between £3.2 million and £5.2 million for both the current and prior year. This audit work was principally performed by Deloitte Touche Tohmatsu Limited member firms, with a number of non Deloitte component auditors reporting to Deloitte Spain for the Spain and Morocco divisional audit. The Group head office work was performed to a component materiality level of £6.4 million, consistent with the prior year.

The five operating divisions and the Group head office function contributed 100% (2015: 100%) of Group revenue and Group operating profit and 99% (2015: 99%) of Group net assets.

Group-level analytical review procedures were performed over the amounts held in the Bahrain joint venture, along with specified audit procedures over certain revenue, cost and balance sheet items performed at our request by non Deloitte component auditors in Bahrain to a component materiality of £2.0 million.

At the parent entity level we also tested the consolidation process.

The Group audit team continued to follow a programme of planned visits that has been designed so that the Senior Statutory Auditor and/or a senior member of the audit team visits each of the five primary divisions where the Group audit scope was focused at least once a year in addition to the work performed at the Group head office. In relation to the current year audit the Senior Statutory Auditor and/or a senior member of the audit team visited Spain, North America, Germany and Bahrain at least once.

Outside of the planned visits regular discussions were held with the component audit teams throughout the year to direct and supervise the planning and execution of their audit work.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006;
- the information given in the Strategic Report and the Directors' Report for the financial year for which the Financial Statements are prepared is consistent with the Financial Statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report and the Directors' Report.

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Matters on which we are required to report by exception

Adequacy of explanations received and accounting records Under the Companies Act 2006 we are required to report to you if, in our opinion: • we have not received all the information and explanations we require for our audit; or • adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or • the parent Company Financial Statements are not in agreement with the accounting records and returns.	We have nothing to report in respect of these matters.
Directors' remuneration Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of Directors' remuneration have not been made or the part of the Directors' Remuneration Report to be audited is not in agreement with the accounting records and returns.	We have nothing to report arising from these matters.
Corporate Governance Statement Under the Listing Rules we are also required to review part of the Corporate Governance Statement relating to the Company's compliance with certain provisions of the UK Corporate Governance Code.	We have nothing to report arising from our review.
Our duty to read other information in the Annual Report Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Report is: • materially inconsistent with the information in the audited Financial Statements; or • apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or • otherwise misleading. In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the Directors' statement that they consider the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed.	We confirm that we have not identified any such inconsistencies or misleading statements.

Respective responsibilities of directors and auditor
As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the Financial Statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Financial Statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team and independent partner reviews.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's 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 Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Scope of the audit of the Financial Statements
An audit involves obtaining evidence about the amounts and disclosures in the Financial Statements sufficient to give reasonable assurance that the Financial Statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the Financial Statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited Financial Statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Stephen Griggs (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London
23 February 2017