Audit and Assurance Committee

Date: **8 October 2014**

Item 6: **External Audit Plan TfL, TTL and Subsidiaries – Year Ending 31 March 2015**

This paper will be considered in public

1 Summary

1.1 To present to the Audit and Assurance Committee KPMG's plan for the audit of the financial statements of Transport for London, Transport Trading Limited (TTL) and its subsidiaries for the year ending 31 March 2015.

2 Recommendation

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

3 Background

3.1 The Plan has been developed by the Appointed Auditor, KPMG, and sets out the work that they propose to undertake for the 2014/15 financial year. The Plan sets out the audit strategy and approach for the audit of the financial statements and also encompasses work relating to Value for Money.

3.2 As was the case for 2013/14, a majority of the subsidiaries of the TfL group will be claiming exemption from audit again this year and the Audit Plan has been drawn up on this basis.

3.3 The proposed total fee for the audit of the TfL Group, excluding the Museum companies and London Transport Insurance Guernsey, for the year ending 31 March 2015 is £1,132,900 (£1,179,400 including them). This represents a reduction of £158k compared with that for the previous year.

3.4 The fee for TfL Corporation and Group is reduced by £14,900 from the previous year, partly because of one-off items in that year but also following further reductions imposed by the Audit Commission.

3.5 The reduction in the fee proposed for TTL Group of 13 per cent reflects KPMG's expectation that they will be able to place increased reliance on certain controls.

List of appendices to this report:

Appendix 1: External Audit Plan 2014/15

List of Background Papers:

None

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Appendix 1

cutting through complexity™

Transport for London

External Audit Plan 2014-15

September 2014

Contents

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Disclaimer

This report is addressed to Transport for London and has been prepared for the sole use of the Transport for London Group (TfL) and the Transport Trading Limited Group (TTL). We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document.

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Robert Brent, who is the engagement Partner to TfL, telephone 020 7311 4736, email robert.brent@kpmg.co.uk who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 016 1236 4000, email trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Investigation Officer, Westward House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SR or by e mail to: complaints@audit-commission.gov.uk. Their telephone number is 0844 798 3131, textphone (minicom) 020 7630 0421

Summary and Scope

This document describes how we shall deliver our audit work for the relevant entities for the year ending 31 March 2015

The scope of work for the TfL and TTL Group accounts is fundamentally unchanged from the prior year

- The TfL Group and Corporation audits are part of the Audit Commission's framework contract. Our statutory responsibilities and powers are set out in the Audit Commission Act 1998, the Local Government Act 1999 and the Audit Commission's Code of Audit Practice (the Code).
- We are required to satisfy ourselves that the accounts of the TfL and TTL Groups comply with statutory requirements (including the CIPFA IFRS-based Code of Practice on Local Authority Accounting for TfL) and that proper practices have been observed in compiling them. We are required to provide audit opinions on the consolidated financial statements of TfL and TTL as well as certain of its subsidiaries
- We are also required to satisfy ourselves that your Annual Governance Statement (AGS) is consistent with our understanding of your operations. Our review of the work of internal audit and consideration of your risk management and governance arrangements are key to this opinion.
- In addition to TfL's financial statements, we are also required to audit and provide an opinion on the Whole of Government Accounts consolidation pack (WGA).
- We are also the auditors of the TTL Group companies, although this appointment falls outside of the remit of the Audit Commission. We set our proposed scope of work for these entities overleaf.
- Set out below is a high level outline of our proposed work and outputs. Further detail is provided in later sections.

Proposed work and output	
Financial statements and Annual Governance Statement	■ Our work will encompass: – a review of the controls over the completion of the accounts; – a detailed audit of the TfL and TTL Group , Victoria Coach Station and Crossrail financial statements and associated disclosure notes; – a review of your Annual Governance Statement (AGS) to confirm that it is in line with our understanding of the business; and – for the TfL and TTL Group Accounts, a review of the consolidation process and testing of journals relating to consolidation adjustments. ■ The findings of this work supports the audit opinion that we issue on your financial statements.
Value for Money	■ Our work in this area shall focus on the same two areas as last year: – whether there are proper arrangements in place for securing financial resilience; and – whether there are proper arrangements for ensuring TfL secures economy, efficiency and effectiveness.

- The audit planning process and risk assessment is an on-going process and the assessment in this plan will be kept under review and updated if necessary. The remainder of this document provides details of our risk assessment, proposed work and fees for our work on the financial statements audit.

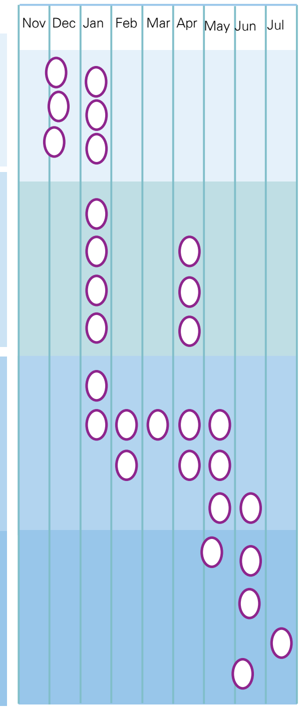
Audit overview

We undertake our work on your financial statements and Annual Governance Statement in four key stages

Our work results in our audit opinion on your financial statements

We set out below a high level overview of our methodology.

1	Planning (1)	■ Perform risk assessment procedures and identify risks ■ Determine audit strategy and identify critical accounting matters. ■ Determine planned audit approach, including reliance on IA
2	Control evaluation (2)	■ Understand accounting and reporting activities. ■ Evaluate design and implementation of selected controls. ■ Test operating effectiveness of selected controls. ■ Assess control risk and risk of significant misstatements.
3	Substantive testing	■ Plan substantive procedures. ■ Perform substantive procedures. ■ Consider if audit evidence is sufficient and appropriate. ■ Perform work on consolidation
4	Completion	■ Perform completion procedures. ■ Perform overall evaluation of the financial statement and disclosures. ■ Form an audit opinion. ■ Audit and Assurance Committee Reporting



1 Preliminary decision of controls or substantive approach for each audit objective.

2 Update and confirm decision on controls or substantive approach for each audit objective.

Audit overview (cont.)

We work with your finance team and internal audit team to enhance the efficiency of the financial statements audit

Subsidiary TTL company audits

Last year TfL took advantage of the audit exemption such that for a large proportion of the subsidiaries no audit opinion is required on the statutory accounts. Audit work will still be required over certain entities to the extent that this audit evidence is required to support the TfL Group opinion, but this is conducted at Group materiality vs local statutory materiality. We have included in Appendix 7 the impact from this exemption for each entity.

Our Audit Process

- We have summarised the four key stages of our financial statements audit process on the previous page.
- As part of our audit process, we will work closely with the finance team to understand and continually improve the accounts production process. We will issue a 'prepared by client' list for each material entity as well as for the Group. This will include a detailed schedule of information requests, tailored to you, to support the financial statements.

Fraud awareness and prevention

- Our audit procedures also include an assessment of your arrangements to deliver your responsibilities to prevent and detect fraud. The auditing standard for fraud, ISA240 (revised), responds to the increased sensitivity to fraud and the importance given to auditors' work on fraud. TfL has a dedicated anti-fraud team and we meet them twice annually to receive an update on activities.
- TfL also participates in the National Fraud Initiative, which is the Audit Commission's computerised data matching exercise designed to detect fraud perpetrated against public bodies. During our audit we will review TfL's progress and actions in following up the matches identified. We use KPMG forensic specialists to perform data analytics on journals posted across the group. This identifies trends and highlights any unusual transactions for further investigation.
- The responsibilities of management and the arrangements with regard to fraud prevention and detection are set out in more detail in the appendices.

Liaising with Internal Audit

- We have a strong working relationship with Internal Audit and we will continue to work closely with them to maximise the effectiveness of their work on core financial systems and governance at TfL. We receive the annual Internal Audit plan and review this to ascertain where specific reviews can assist us in our controls work. In addition we also use these reports to inform our understanding of the entity and its wider control environment. Specifically, the Internal Audit function's work on anti-fraud informs our own fraud assessments.
- We have met with internal audit as part of our audit planning and have established quarterly meetings so we can keep up to date with work throughout the year. We will use the work to inform us of issues as they arise so we can adapt out own work and where timings and scope allow will seek to place reliance on their work where it is efficient to do so.

Whole of Government Accounts (WGA)

KPMG are required to review and report on your WGA consolidation pack in accordance with the approach agreed with HM Treasury and the National Audit Office. We will carry out part of this work at the same time as our final accounts work and will complete this work ahead of the deadline of October 2015.

Materiality and reporting of audit differences

We have considered the appropriate level at which to report audit differences for discussion with the Audit and Assurance Committee

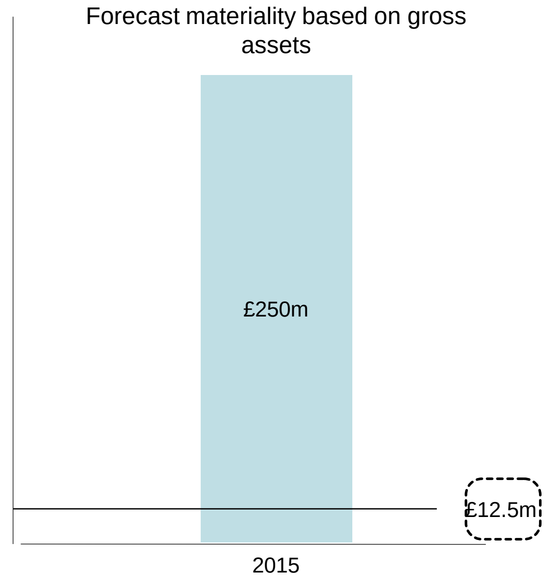
We shall use this slide as the basis of the explanation in our report of how we applied the concept of materiality in planning and performing the audit

Materiality

Generally Accepted Auditing Standards (GAAS) require that we plan our audit to determine with reasonable confidence whether or not the financial statements being reported on are free from material misstatement.

An omission or misstatement is regarded as material if it would reasonably influence the user of financial statements. This therefore involves an assessment of the qualitative and quantitative nature of omissions and misstatements.

Generally, we would not consider difference in opinion in respect of areas of judgement to represent 'misstatements' unless the application of that judgement results in a financial amount falling outside of a range which we consider to be acceptable.



Note: (a) Materiality will be lower for standalone subsidiary audits.

Materiality for the Group has been set at £250million (2014:£200 million) which is 0.7% of gross assets.

We design our procedures to detect errors at a lower level of precision, set at £187.5million, and we have some flexibility to adjust this level downwards.

Reporting to the Audit and Assurance Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit and Assurance Committee any misstatements of lesser amounts to the extent that these are identified by our audit work.

Under ISA 260, we are obliged to report omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

ISA 450 requires us to request that uncorrected misstatements are corrected.

In the context of TfL we propose that an individual difference could normally be considered to be clearly trivial if it is less than £12.5million.

If management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit and Assurance Committee to assist it in fulfilling its governance responsibilities.

- We propose to report all individual unadjusted differences greater than £187.5million to the Audit and Assurance Committee.
- We propose to report in aggregate all smaller errors between £12.5 million and £187.5 million.
- We will also have regard to other errors below this amount if evidence of systematic error or if material by nature.

Financial statement audit risks

Our risk assessment draws upon our historic knowledge of the business, the industry and the wider economic environment in which TfL operates

We also use our regular meetings with senior management to update our understanding and take input from local audit teams and internal audit reports

This and the following slides will form the basis of the description of the assessed risks of material misstatement having the greatest effect on our audit and the work of the audit team that we are required to include in our auditor's opinion

Note: the size of the bubbles does not have any significance

Financial statement audit risks (cont.)

For each significant financial statement risk we have outlined the impact on our audit plan

We will provide an update to the Audit and Assurance Committee on these risk issues as part of our Report to those charged with Governance in June 2015

Significant risks	Why	Our audit approach
Capitalisation of costs	On the majority of projects undertaken within TfL and TTL a judgment needs to be made concerning the split of costs between capital and operating expenditure. In many cases, projects will involve a mix of repairs and maintenance (operating expenditure) and replacement (capital expenditure). Where costs are capitalised the economic useful lives of the asset needs to be determined which involves further judgment. In addition, given the current economic environment there is an increased risk of projects being terminated or suspended, which increases the risk of potential write-offs of assets. The treatment of costs associated with such projects will need to be carefully considered.	We will review the split of capital and revenue for new additions and understand how useful lives are determined and monitored. We will also discuss significant aborted projects with management and determine how any associated costs have been accounted for. This will include a review of any project re-profiling. We will test year end accruals for completeness and accuracy.
Completeness of provisions and accruals	TfL is subject to claims from contractors in respect of projects and contracts, as well as disputes in the ordinary course of business (for example, on compulsory purchases). The assessment of the amount to be provided in respect of such claims is a highly subjective matter and could significantly impact the financial position of individual Company's and the Group	Where we are aware of claims we will meet with management to discuss and fully understand the nature of the claims and how any provision has been calculated, including reviewing the assumptions underpinning this judgement as well as a review of any supporting documentation. We will also meet with the Director of Legal to determine whether any other claims have been received and review the treatment of these claims. We will also review the Board minutes to identify any potential claims which have not been provided for.

Financial statement audit risks (cont.): significant risks that ISAs require us to raise in all cases

We highlight significant risks that ISAs require us to raise

We have outlined the impact on our audit plan

We will provide an update to the Audit and Assurance Committee on these risk issues as part of our Report to those charged with Governance in June 2015

Significant risks that ISAs require us to raise in all cases	Why	Our audit approach
Fraud risk from revenue recognition	Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk. However, most of TfL is a cash based business, therefore fraud risk from revenue recognition is not regarded as significant in this area.	Although we have rebutted the presumed risk of fraud from revenue recognition, we will remain alert to indications of fraud during the course of the audit, and to respond accordingly.
Fraud risk from management override of controls	Professional standards require us to communicate the fraud risk from management override of controls as significant because management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We have not identified any specific additional risks of management override relating to this audit. .	Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, both group and component auditors carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the component's normal course of business, or are otherwise unusual.

Other areas of audit focus

We set out here other areas of audit focus

We have outlined the impact on our audit plan

We will provide an update to the Audit and Assurance Committee on these risk issues as part of our Report to those charged with Governance in June 2015

Other areas of audit focus	Why	Our audit approach
Prudential Indicators	Under the Local Government Act 2003 the Mayor must determine and keep under review how much money TfL and the other functional bodies can afford to borrow. TfL may not borrow money if doing so would result in a breach of this limit. TfL has voluntarily developed a set of specific local indicators, referred to as voluntary or discretionary indicators, calculated on the basis of the Group accounts.	We shall: ▪ review TfL's performance against these prudential indicators as part of our audit. As part of our assessment of going concern we will review the forecast position for the 12 month period from the date of signing the accounts, in order to assure ourselves that the indicators will not be breached; ▪ review the methodology followed in calculating the indicators; ▪ re-perform the calculations in the papers to the Finance and Investment Committee; and ▪ agree the calculations on prudential indicators through to the Business Plan.
Grants and Funding	TfL currently receives significant funding through the Transport Grant from the DfT. The specific amounts are agreed as part of each spending review. The amounts set out in the funding agreement are then used as part of TfL's financial plans, including the Investment Programme. The Crossrail project is funded through a variety of mechanisms, the significant elements of which are passed through the DfT and through TfL. Of the £14.8 billion funding required over the life of the project some £7.1 billion will be provided by TfL through a variety of sources. There are a number of conditions attached to both the Transport Grant funding (mainly associated to the delivery of the TfL Business Plan and Investment Programme) and the Crossrail project funding which must be met to ensure this funding is continued.	Throughout our audit, and up until the date of signing, we will: ▪ review the conditions attached to the funding and assess TfL's actual and forecast compliance with them; ▪ review correspondences with agencies such as the GLA and the DfT to understand the arrangements for future years, and ensure TfL's financial plans had taken the changes in arrangements into account.; ▪ hold discussions with project/business accountants on all significant projects and corroborate that through discussions with senior management to identify any issues; and ▪ agree grants awarded to TfL to source documentation.

Other areas of audit focus (cont.)

We set out here some other areas of audit focus

We have outlined the impact on our audit plan

We will provide an update to the Audit and Assurance Committee on these risk issues as part of our Report to those charged with Governance in June 2015

Other areas of audit focus	Why	Our audit approach
Property valuations and process controls over transactions	TfL has a significant property portfolio subject to valuation, part of which is done internally. The classification between investment properties and infrastructure under IFRS is judgemental. .	We shall: ■ use our valuation specialists to independently challenge management's assumptions; ■ hold discussions with DTZ and Cushman & Wakefield along with the TfL Property team; ■ perform walkthroughs and test controls over property additions and disposals and subsequent recording in SAP; and ■ substantively test documentation and audit trail over property additions and disposals including review of lease contracts and accounting thereof.
Treasury	Outstanding derivative contracts need to be tested for hedge effectiveness in line with IFRS guidance. There are extensive disclosures in group and subsidiary accounts.	We shall: ■ review the results of both prospective and retrospective hedge effectiveness test on outstanding contracts; ■ challenge management's assessment that hedge forecasted borrowings are still highly probable; ■ review Treasury Board Policy and meeting minutes of the Finance Committee; and ■ review key IAS 39 accounting polices and IFRS 7 disclosures within the Group Accounts.
Defined benefit pension	There is a significant pension deficit on group balance sheet. The valuation subject to complex actuarial assumptions.	We shall: ■ involve our actuarial specialists to independently challenge management's assumptions and held discussions with Punter Southall; ■ review the appropriateness of the IAS 19 valuation methodology; and ■ agree underlying data sent to actuaries and agreed asset values to underlying investment managers statements.

Other areas of audit focus (cont.)

We set out here some other areas of audit focus

We have outlined the impact on our audit plan

We will provide an update to the Audit and Assurance Committee on these risk issues as part of our Report to those charged with Governance in June 2015

Other areas of audit focus	Why	Our audit approach
Contactless payment	This is the first year that a significant proportion of revenue will be generated using contactless payment. The controls and processes over contactless payments differ to those in relation to Oyster.	We shall: ■ review the IT systems and controls in place over contactless payment using our IT specialists; ■ carry out a walkthough of the system and manual and automated controls in place; and ■ perform analytical procedures over revenue from contactless payment.

Independence confirmation

Our independence and objectivity responsibilities under the Code are summarised in Appendix 3

We confirm our audit team's independence and objectivity is not impaired

Independence and objectivity confirmation

- Professional standards require auditors to communicate to those charged with governance, at least annually, all relationships that may bear on the firm's independence and the objectivity of the audit Engagement Partner and audit staff. In this regard we refer you to our six monthly reports on all services provided to the TfL Group. The standards also place requirements on auditors in relation to integrity, objectivity and independence.
- International Standard on Auditing (UK&I) 260 defines 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case this is the Audit and Assurance Committee.
- KPMG LLP is committed to being and being seen to be independent. APB Ethical Standard 1 Integrity, Objectivity and Independence requires us to communicate to you in writing all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the Engagement Lead and the audit team.

Confirmation statement

- We confirm that as of 30 September 2014 in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Appointed Auditor, and the objectivity of the audit team, is not impaired.

Audit fees

We set out here our proposed audit fees for the financial statements audits of the Group entities, the Value for Money assessment and Whole of Government Accounts opinion.

Our Audit Fee letter 2014-15 presented to you in June 2014 first set out our fees for the Corporation and Group audit. We have not considered it necessary to make any changes to the agreed fees at this stage. Our audit fee includes our work on the VFM conclusion and our audit of the Corporation and Group financial statements. We also set out below our proposed fee for the TTL Group.

For 2014-15 we have proposed a significant reduction on the TTL Group fee of 13%. As reported following the 2013/2014 year end audit, our initial review of the control issues identified during the 2012/2013 audit indicates that appropriate management action has been taken to address the concerns and controls weaknesses. We could not place reliance on these controls during the 2013/2014 audit as the improvements were not in place throughout the year. However for the forthcoming 2014/2015 audit our assumption is that we can test and place reliance on these controls, and accordingly reduce the substantive test work previously required. This is reflected in the reduced fee proposal. Should we find that the controls as amended are not operating effectively we may need to review our approach and revert back to substantive testing, and under this scenario we would need to revisit the fee as incremental audit hours are likely to be necessary

Element of the audit	2014-15 (planned)	2013-14 (actual)	2013-14 (planned)
Corporation and TfL Group*	£207,900	£222,800	£222,800
TTL Group**	£925,000	£1,068,000	£1,068,000
Total (excluding LTIG and LTM)	£1,132,900	£1,290,800	£1,290,800

**The Audit Commission has set the scale fee for 2014-15 at £207,900.*

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Audit timeline and deliverables

We will discuss and agree each report with management prior to publication

Deliverable	Purpose	Timing
Planning		
Audit plan	■ Outline audit approach. ■ Identify areas of audit focus and planned procedures. ■ Confirm plan with Audit and Assurance Committee.	October 2014
Final Audit		
Report to those charged with governance (ISA 260)	■ Auditor's report on financial statements. ■ Auditor's report on TfL's value for money. ■ Detail the resolution of key audit issues. ■ Communication of adjusted and unadjusted audit differences. ■ Performance improvement recommendations identified during our audit.	June 2015
Opinion on financial statements	■ Financial Statements opinion.	July 2015
Value for Money		
Opinion on economy, efficiency and effectiveness	■ Value for Money conclusion.	July 2015
Annual Audit Letter		
Annual Audit Letter	■ High level summary of work carried out.	October 2015

Appendices

Meeting your expectations

We have summarised how we plan to meet your expectations.

How we will conduct ourselves

Communications

- We will be proactive in developing relationships with your staff where our audit work requires their input.
- We will ensure that telephone calls, letters and emails are answered within a reasonable timeframe.
- We will ensure that all recommendations, and in particular those relating to our performance management work, are included within our Annual Audit Letter only after having been agreed with relevant Officers.
- Robert Brent will attend all Audit and Assurance Committee meetings and ensure that other relevant KPMG staff are invited as appropriate.

Working together

- We will ensure that the Chief Finance Officer, Head of Group Financial Accounting and other key members of staff are kept informed of the progress of our audit work throughout the year.
- We will liaise with staff at all levels of the Group to ensure that our work is appropriately planned and completed and where recommendations are made these are agreed with the responsible officer.

Cooperating with TfL

- We will continue to coordinate our work with that of internal audit and ensure that we provide appropriate proactive commentary to the finance function on issues that affect TfL's accounts.
- We will respond promptly to requests for comment on aspects of the TfL's operations, where appropriate.

Our expectations of your support

Audit Plan

- Brief our staff on key issues affecting TfL.
- Review and agree the draft plan.

Interim Audit

- Ensure that key officers are available for the duration of our audit.
- Respond to and agree our draft reports in good time.

Accounts Audit

- Ensure that a full draft of the account packs are available on the agreed start date of our audit, and that only agreed adjustments are put into the accounts following receipt of this draft.
- Produce the documents listed within our prepared by client request by the agreed start date of our audit.
- Ensure that the mandatory content of the Annual Report is available at the agreed time of our final account audit.

Annual Audit Letter

- Discuss and agree our draft Annual Audit Letter in good time for the Audit and Assurance Committee.
- Ensure that all action plans are agreed and followed up in due course.

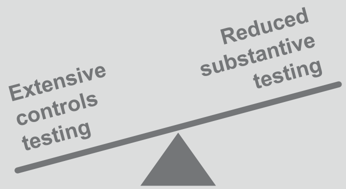
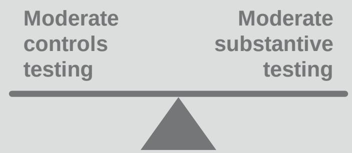
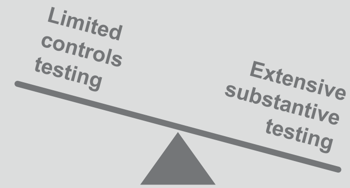
Other work

- Agree a key contact as a focal point for the study or work.
- Discuss and review our findings so that action plans can be fully completed and implemented.

Balance of internal controls and substantive testing

This appendix illustrates how we determine the most effective balance of internal controls and substantive audit testing

Emphasis of testing

What we do	Accounts/transactions suited to this testing	For example KPMG's approach to:
 Extensive controls testing Reduced substantive testing	■ Low value transactions ■ High volume ■ Homogenous transactions ■ Little judgement	■ Revenue and debtors ■ Purchases and payables ■ Payroll
 Moderate controls testing Moderate substantive testing	■ Low/medium value ■ High/medium volume ■ Some areas requiring judgement	■ Fixed Assets
 Limited controls testing Extensive substantive testing	■ High value ■ Low volume or ■ Unusual non-recurring ■ Accounting estimates ■ Significant judgements	■ Valuation of provisions and fixed assets ■ Investment properties ■ Financial Instruments ■ Pensions

Note: Assuming controls are found to operate as designed.

Independence and objectivity requirements

This appendix summarises the auditor's responsibilities regarding independence and objectivity

Independence and objectivity

- Auditors are required by the Code to:
  - carry out their work with independence and objectivity;
  - exercise their professional judgement and act independently of both the Commission and the audited body;
  - maintain an objective attitude at all times and not act in any way that might give rise to, or be perceived to give rise to, a conflict of interest; and
  - resist any improper attempt to influence their judgement in the conduct of the audit.
- In addition, the Code specifies that auditors should not carry out work for an audited body that does not relate directly to the discharge of the auditors' functions under the Code. If TfL invites us to carry out risk-based work in a particular area, which cannot otherwise be justified to support our audit conclusions, it will be clearly differentiated as work carried out under section 35 of the Audit Commission Act 1998.
- The Code also states that the Commission issues guidance under its powers to appoint auditors and to determine their terms of appointment. The Standing Guidance for Auditors includes several references to arrangements designed to support and reinforce the requirements relating to independence, which auditors must comply with. These are as follows:
  - any staff involved on Commission work who wish to engage in political activity should obtain prior approval from the Partner;
  - audit staff are expected not to accept appointments as lay school inspectors;
  - firms are expected not to risk damaging working relationships by bidding for work within an audited body's area in direct competition with the body's own staff without having discussed and agreed a local protocol with the body concerned;
  - auditors are expected to comply with the Commission's statements on firms not providing personal financial or tax advice to certain senior individuals at their audited bodies, auditors' conflicts of interest in relation to PFI procurement at audited bodies, and disposal of consultancy practices and auditors' independence;
  - auditors appointed by the Commission should not accept engagements which involve commenting on the performance of other Commission auditors on Commission work without first consulting the Commission;
  - auditors are expected to comply with the Commission's policy for the Engagement Lead to be changed on each audit at least once every five years (subject to agreed transitional arrangements). Audit suppliers are required to obtain the Commission's written approval prior to changing any Engagement Lead in respect of each audited body;
  - audit suppliers are required to obtain the Commission's written approval prior to changing any Engagement Lead in respect of each audited body; and
  - the Commission must be notified of any change of second in command within one month of making the change. Where a new Engagement Lead or second in command has not previously undertaken audits under the Audit Commission Act 1998 or has not previously worked for the audit supplier, the audit supplier is required to provide brief details of the individual's relevant qualifications, skills and experience.

Fraud

This appendix summarises the changes to KPMG's audit management processes

Consideration of fraud

- Auditing standards require that we consider the possibility of fraud (in the context of pervasive and specific risks) at all stages of the audit process;
- Our approach to fraud risks in 2014-15 will include a one-on-one discussions with senior management, those charged with Governance, internal audit and your Head of Fraud, and consideration of TfL's process for confirming and reporting instances of fraud.

Respective responsibilities of management, those charged with governance and audit

- It is the responsibility of management to establish a control environment and maintain policies and procedures to assist in achieving the objective of ensuring, as far as possible, the orderly and efficient conduct of the entity's business.
- It is the responsibility of those charged with governance to ensure, through oversight of management, the integrity of an entity's accounting and financial reporting systems and that appropriate controls are in place, including those for monitoring risk, financial control and compliance with the law.
- An audit is designed to provide reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. The fact that an audit is carried out may act as a deterrent, but the auditor is not and cannot be held responsible for the prevention of fraud and error under the Auditing Standards.

The Bribery Act

- The Act came into force on the 1 July 2012. The legislation specifically creates a potential new criminal offence on the employer of failing to prevent bribes paid on their behalf. The only defence for an entity is that it 'had in place adequate procedures designed to prevent a person associated with it from undertaking such conduct'. The Ministry of Justice and the Serious Fraud Office have both issued guidance as to what entities need to have in place in order to meet this requirement
- The Act will potentially expose Board members and Senior Management to personal liability and criminal charges if an organisation is found to be in breach of certain key provisions within the Act.
- The Act provides for unlimited fines and prison sentences of up to ten years, or a combination of the two, if a person is convicted of bribery, and employers convicted of bribery are subject to an unlimited fine which must be paid from personal expense.

Audit Quality - Audit Quality Framework

Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion

To ensure that every partner and employee concentrates on the fundamental skills and behaviours required to deliver an appropriate and independent opinion, we have developed our global Audit Quality Framework

Audit Quality Framework	
Seven key drivers of audit quality	**Impact on our audit approach**
Tone at the top Tone at the top is the umbrella that covers all the drivers of audit quality and maximizes our outcomes through a focused and consistent voice.	■ The tone is set at the top through your Engagement Partners. They lead by example with a clearly articulated audit strategy; committing a significant proportion of time throughout the audit and directing and supporting the team.
Association with the right clients One of the keys to managing audit quality is to understand the nature of our clients' business and the issues they face and build a robust audit response to the identified risks.	■ We have set out within this plan the key financial statement risks we have identified as part of our planning. For many of these, such as IT and treasury, we will supplement our core audit team with specialists to ensure we provide a robust audit response.
Clear standards and robust audit tools Professional practice, risk management and quality control are the responsibilities of every KPMG partner and staff member. We expect our people to adhere to the clear standards we set and we provide a range of audit tools to support them in meeting these expectations.	■ We dedicate significant resources to keeping our standards and tools complete and up to date. The global rollout of KPMG's eAudIT application has significantly enhanced existing audit functionality. eAudIT enables KPMG to deliver a highly effective audit which is compliant with all professional standards.
Recruitment, development and assignment of appropriately qualified personnel One of the key drivers of audit quality is ensuring the assignment of partners and staff members appropriate to TfL's risks and industry.	■ As well as your core audit team we use a variety of specialists all with significant knowledge of TfL to ensure that we are best placed to respond to your risks. Further details are set out on page 22.
Commitment to technical excellence and quality service delivery We ensure that our people bring to you the most up to the minute and accurate technical solutions and together with our specialists are capable of solving the most complex audit issues and delivering valued insights.	■ We promote technical excellence and quality service delivery through training and accreditation, developing business understanding and industry knowledge, investment in technical support, development of specialist networks, and effective consultation processes.
Performance of effective and efficient audits We understand that how an audit is conducted is as important as the final result. Our drivers of audit quality maximize the performance of the engagement team during the conduct of every audit.	■ Our report to those charged with governance summarises our audit findings and sets out our response to your key risks.
Commitment to continuous improvement We focus on ensuring our work continues to meet the needs of participants in the capital markets. To achieve this goal, we employ a broad range of mechanisms to monitor our performance, respond to feedback and understand our opportunities for improvement.	■ We use a number of internal inspection programmes, including reviews of firm wide procedures and a sample of audit engagements. ■ We operate a formal programme to actively solicit feedback from clients on the quality of specific services that we have provided. ■ We also use the feedback received from TfL as part of your review of effectiveness of external audit to improve our audit year on year.

Key audit team and specialists

Your core team is set out here and all core members have worked with TfL before

TfL
Robert Brent (Partner)

- **TfL Corporation**
  Robert Brent (Partner)
  - *Rebecca Pett (Senior Manager)*
    - *Susan Harris (Senior Manager)*
- **TTL Group**
  Robert Brent / Ian Griffiths (Partners)
  - *Malcolm Footer*
    (Senior Manager – TTL Group and Crossrail)
  - *Rebecca Pett*
    (Senior Manager - LUL)

Michael Evertt
Tax

Seri Malak
Tax

Umar Mahmood
Treasury

Greg McIntosh
Local Government

Keith Bannister
IT

Ben Foulser
IT

Naz Peralta
Pensions

Ed Brogden
Pensions

Will Gray
Valuations

Subsidiary audit scope

As in the prior year TfL plan to utilise the audit exemption that removes the requirement for audit opinions to be issued on subsidiary statutory accounts

Audit testing will still be performed on major projects, claims and project accruals to support the TfL and TTL Group audit opinions

While statutory accounts are still required to be prepared and filed there will be no audit review on these accounts, and management will need to ensure that internal review processes are in place

Subsidiary audit scope

- As in the previous year TfL is proposing taking the audit exemption for all of the TTL subsidiary entities (with the exception of Crossrail Ltd, Victoria Coach Station Ltd and London Transport Museum Ltd) as set out in section 479A of the Companies Act 2006. NB: The audit of LTIG is not impacted by the audit exemption and a full statutory audit will be carried out.
- This requires a parent company (in this case TTL) to issue and file a guarantee with Companies House whereby the parent becomes the guarantor of each and every liability of the subsidiary existing at that year-end until it is satisfied in full. This covers liabilities recognised at the balance sheet date, and also "all outstanding liabilities" so would also include future lease or pension liabilities and will include contingent and prospective liabilities, since these are a variety of liability.
- Consistent with 2013-14, there is no exemption from preparing and filing the subsidiary accounts; although no audit opinion will be issued on the subsidiary accounts where the exemption is applied.
- For those entities not requiring a statutory audit we will apply group materiality. This means the level of detailed testing carried out on some entities will be less than if we were required to carry out a statutory audit to individual materiality levels.
- We have set out the level of detailed testing we will carry out over each entity in the table below, compared to the work that would be required to form a statutory audit opinion (and the work carried out in 2012-13 when we carried out full audits to local materiality for all entities).
- We shall only review the financial statements of the entities requiring a statutory audit opinion.

Statutory Audit required to local materiality	Entity a critical component (significant work will be carried out approx 90% of the work carried required for a statutory audit)	Entity a major component (some work to be carried out approx 50% of the work carried out for a statutory audit)	No work required and no audit work shall be performed
▪ TfL Group ▪ TfL Corporation ▪ TTL Group ▪ Crossrail Ltd ▪ Victoria Coach Station Ltd ▪ LTIG ▪ London Transport Museum Ltd ▪ London Transport Museum (Trading) Ltd	▪ London Underground Ltd ▪ London Bus Services Ltd ▪ LUL Nominee BCV Ltd ▪ LUL Nominee SSL Ltd ▪ Tube Lines Ltd	▪ Rail for London Ltd ▪ Docklands Light Railway Ltd ▪ Tramtrack Croydon Ltd ▪ Transport for London Finance Ltd ▪ Tube Lines (Finance) plc	▪ City Airport Rail Enterprises plc ▪ Woolwich Arsenal Rail Enterprises Ltd ▪ City Airport Rail Enterprises (Holdings) Ltd ▪ Woolwich Arsenal Rail Enterprises (Holdings) Ltd ▪ London Buses Ltd ▪ London River Services Ltd ▪ Tube Lines (Holdings) Ltd

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