

Date: 11 October 2017

Item: Effectiveness Review of the External Auditors

This paper will be considered in public

1 Summary

- 1.1 To report to the Audit and Assurance Committee on external auditor effectiveness.
- 1.2 A more detailed paper is also included on the Part 2 agenda as it contains a number of detailed comments on Ernst & Young's (EY's) performance during the audit, that are commercially sensitive.

2 Recommendation

- 2.1 **The Committee is asked to note the paper and the supplemental information on Part 2 of the agenda.**

3 Background

- 3.1 The Terms of Reference of the Audit and Assurance Committee, as set out in the document "TfL Committees and Panels", require the Committee to review formally the performance of the external auditors at least annually. This review covers the performance of the external auditors of all parts of the TfL Group where EY is the auditor.
- 3.2 The Terms of Reference do not specify the means by which auditor performance is to be assessed. Other guidance is available, one of the more recent of which is the Financial Reporting Council 2016 publication "Guidance on Audit Committees". This is an update of guidance first published in 2003 and subsequently updated in 2008. It is based on the UK Corporate Governance Code, and although this relates to listed companies, the principles are also relevant to entities such as TfL.
- 3.3 The Guidance identifies four criteria in assessing external auditors:
 - (a) Qualification;
 - (b) expertise and resources;
 - (c) effectiveness; and
 - (d) independence.
- 3.4 EY is the auditor of all entities within the TfL group (with the exception of London Transport Museum, which is audited by Kingston Smith LLP). Both EY and Kingston Smith LLP are "registered auditors" and are required to

comply with the Audit Regulations which cover such matters as independence and integrity, maintaining competence, compliance with technical standards and monitoring compliance with the Regulations. These requirements ensure that the criterion regarding qualification is addressed.

- 3.5 Independence of the external auditors is dealt with through separate reports to the Audit and Assurance Committee on fees for non-audit services and on independence and objectivity, both reported twice a year. External auditors are appointed by Public Sector Audit Appointments Limited, the successor body to the Audit Commission, under a statutory process, and this provides additional safeguards in terms of independence.
- 3.6 This paper deals with assessing the remaining two criteria in the Guidance, namely the effectiveness, and also the expertise and resources, of EY as external auditors. The London Transport Museum is not material to the group as a whole and the effectiveness of the Museum audit was discussed at its own Audit Committee.

4 Methodology for assessing external auditor effectiveness and expertise

- 4.1 A questionnaire was devised and distributed to key finance staff and senior management to obtain their views on the conduct and effectiveness of the external audit, including the expertise and resources of the external auditors.
- 4.2 For the first time, a separate questionnaire was also devised and distributed to members of the Audit and Assurance Committee to assess the quality and effectiveness of EY's performance and reporting across the Group in respect of the audit of the year ended 31 March 2017.
- 4.3 Responses from key staff were sought under four main headings:
- (a) audit planning and preparation;
 - (b) field work;
 - (c) closing meetings and sign-off; and
 - (d) general.
- 4.4 Responses from the Audit and Assurance Committee were sought under the headings:
- (a) assessing the auditor's judgements about materiality;
 - (b) risk assessment;
 - (c) nature and extent of audit work; and
 - (d) audit conclusions and auditor reporting.
- 4.5 The questionnaires provided respondents with an opportunity to comment on the specific questions and also respond on more general free-form topics.
- 4.6 Questionnaires were sent out to all parts of the business and to the Audit and Assurance Committee, and most were completed and returned. Some parts of the business consolidated their responses into one return for that business unit. The Finance Shared Services Centre and the Group Accounting team were also covered.

4.4 Respondents were asked to score responses on a 1 to 3 scale, with 3 being the top score. Average scores were calculated for each part of the questionnaire.

5 Conclusions on External Auditor Effectiveness and Expertise

5.1 Overall Committee members were satisfied with EY's performance as external auditors during 2016/17. Average scores ranged from 2.7-3.0.

5.2 TfL finance staff were also generally satisfied with EY performance. Given that this was a second year of EY as auditors the scores on average were higher than the prior year although the range remained similar with individual questions achieving average scores ranging from 2.0-3.0 (2015/16: 2.1-3.0).

5.2 It was noted that the efficiency and focus of the audit were improved on the prior year, and that EY had taken on board suggested improvements from the 2015/16 feedback. It was also observed that EY made good use of its data analytic tools and used these to feed back insightful comments to management.

5.3 The questionnaire asked if there were any members of the audit team that TfL staff would single out for their strong personal contribution. Several names were mentioned and these have been fed back to the partners.

List of appendices to this report:

Supplementary exempt information is attached to Part 2 of the agenda.

List of Background Papers:

None

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