

**TRANSPORT FOR LONDON**

**AUDIT COMMITTEE**

**SUBJECT:                   AUDIT AND INSPECTION PLAN 2008/09**

**MEETING DATE:           12 MARCH 2008**

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**1       Purpose and decision required**

1.1     This plan has been developed by the Relationship Manager and the Appointed Auditor, KPMG LLP. It sets out the audit and inspection work that they propose to undertake in the 2008/09 financial year in accordance with statutory requirements.

**2       Background**

2.1     The Director of Internal Audit and the Chief Finance Officer have been consulted on the Plan.

**3       Recommendation**

3.1     The Committee is asked to NOTE the Plan and make any comments as appropriate.

Audit and Inspection Plan

Date

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# Audit and Inspection Plan

**Transport for London**

**Audit 2007/089**

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### **Status of our reports to Transport for London (TfL)**

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

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- any third party.

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## Introduction

- 1 This plan has been developed by the Relationship Manager and the Appointed Auditor, KPMG LLP. It sets out the audit and inspection work that we propose to undertake in the 2008/09 financial year. The plan is based on the Audit Commission's risk-based approach to audit planning. It reflects:
  - audit and inspection work specified by the Audit Commission for 2008/09;
  - current national risks relevant to your local circumstances; and
  - your local risks and improvement priorities.
- 2 The audit planning process for 2008/09, including the risk assessment, is an ongoing process and will continue as the year progresses, and the information and fees in this plan will be kept under review and updated as necessary.
- 3 This plan relates to the audit of the Transport for London Corporation and Group. It does not include the plan for Transport Trading Limited and its subsidiaries.

## Responsibilities

- 4 We comply with the statutory requirements governing our audit and inspection work, in particular:
  - the Audit Commission Act 1998;
  - the Local Government Act 1999 (best value inspection and audit); and
  - the Code of Audit Practice.
- 5 The Code of Audit Practice (the Code) defines auditors' responsibilities in relation to:
  - the financial statements (including the statement on internal control (SIC)); and
  - the audited body's arrangements for securing economy, efficiency and effectiveness in its use of resources.
- 6 The Audit Commission's Statement of responsibilities of auditors and of audited bodies sets out the respective responsibilities of the auditor and TfL. The Audit Commission has issued a copy of the Statement to every audited body.
- 7 The Statement summarises where the different responsibilities of auditors and of the audited body begin and end, and our audit work is undertaken in the context of these responsibilities.

## Inspection

- 8 The Audit Commission's inspection activity is underpinned by the principle of targeting our work where it will have the greatest effect, based upon assessments of risk and performance.
- 9 Our direction of travel and use of resources work for 2007/08 has helped to inform our planning process for this year. Based on the results of the planning process we have identified where our inspection activity will be focused for 2008/09 as follows.

**Table 1 Summary of inspection activity**

| Inspection activity                  | Reason/impact                                                                                                                                                              |
|--------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Relationship Manager (RM) role       | To act as the Commission's primary point of contact with TfL and the interface at the local level between the Commission and other key stakeholders.                       |
| Direction of travel (DoT) assessment | An annual assessment, carried out by the RM, of how well TfL is securing continuous improvement. The DoT assessment summary will be published on the Commission's website. |

Over the next few years, the current programme of corporate assessments will be replaced by Comprehensive Area Assessment ('CAA'). CAA will be introduced from 1 April 2009 and the first scores under CAA are due to be published in autumn 2009. The Audit Commission is currently holding discussions with TfL and other members of the GLA group on how the new framework will apply to the GLA bodies.

## Work under the Code of Audit Practice carried out by the Appointed Auditor

### Financial statements

- 10 KPMG will carry out their audit of the financial statements in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (APB).
- 11 KPMG will issue an opinion on whether the financial statements present fairly, in accordance with applicable laws and regulations and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2008, the financial position of TfL as at 31 March 2009 and its income and expenditure for the year.
- 12 KPMG are also required to review whether the Statement of Governance Assurance has been presented in accordance with relevant requirements, and to report if it does not meet these requirements or if it is misleading or inconsistent with their knowledge of TfL.

### Use of resources

#### Value for money conclusion

- 13 The Code requires KPMG to issue a conclusion on whether TfL has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money conclusion. In arriving at this conclusion, KPMG consider a standard set of criteria issued by the Audit Commission.
- 14 In meeting this responsibility, KPMG will review evidence that is relevant to TfL's corporate performance management and financial management arrangements. Where relevant work has been undertaken by other regulators, KPMG will normally place reliance on their reported results to inform their work.
- 15 KPMG will also follow up their work from previous years to assess progress in implementing agreed recommendations.

#### Use of resources assessment

- 16 KPMG will complete a Use of Resources assessment, as specified by the Audit Commission, in Autumn 2008. This assessment will be based on the underlying key lines of enquiry for the five themes of financial reporting, financial management, financial standing, internal control and value for money. This process will be broadly similar to the review carried out in 2007 and will consider TfL's performance in the 2007/08 financial year.

- 17 There will be significant changes to the criteria used for the assessment relating to the 2008/09 financial year. The new criteria (which as noted earlier have not yet been tailored to take into account the specific circumstances of the GLA group) will emphasise the importance of improved value for money outcomes for local people. It is based on wider considerations other than cost and performance. It will also look at how commissioning and procurement are improving efficiency and how non-financial resources are used to support value for money.
- 18 The overall judgement will be based upon the evidence from three themes (managing money, managing the business and managing other resources) and will give particular emphasis to the value for money outcomes being achieved. The Audit Commission is currently consulting on the Use of Resources assessment for 2009 and detailed guidance on the methodology is due to be released by the Audit Commission in April 2009. The first scores under the new CAA framework are due to be published in Autumn 2009 as part of the overall reporting of CAA at that time. The Audit Commission has not yet indicated whether it expects the assessment in respect of the GLA group to follow the same timetable.
- 19 Once the methodology applicable to TfL and timetable for the work have been agreed, KPMG will report details of the scores and judgements made to Transport for London. The scores will be accompanied, where appropriate, by recommendations for improvement.
- 20 The work required to arrive at the use of resources assessment is fully aligned with that required to arrive at the auditor's value for money conclusion. The auditor's scores are also reported to the Commission and are used as the basis for its overall use of resources judgement for the purposes of CAA.

## Data quality

- 21 The Audit Commission has specified that auditors will be required to undertake audit work in relation to data quality. The work to be carried out in 2008/09, which is based on arrangements in place and data for 2007/08, is also broadly similar to that carried out in 2007. The work is based on a three-stage approach covering:
  - Stage 1 - management arrangements;
  - Stage 2 - completeness check; and
  - Stage 3 - risk-based data quality spot checks of a sample of performance indicators.
- 22 The work at stage 1 will link to KPMG's review of TfL's arrangements to secure data quality as required for their value for money conclusion and, together with the results of stage 2, will inform the risk assessment for the detailed spot check work to be undertaken at stage 3.
- 23 KPMG's fee estimate reflects an assessment of risk in relation to TfL's performance indicators. This risk assessment may change depending on the assessment of their overall management arrangements at stage 1 and they will update the plan accordingly, including any impact on the fee.

## Assessing risks

- 24 We are committed to targeting our work where it will have the greatest effect, based upon assessments of risk and performance. This means planning our audit work to address areas of risk relevant to our audit responsibilities and reflecting this in the audit fees. It also means making sure that our work is co-ordinated with the work of other regulators, and that our work helps you to improve.
- 25 Our risk assessment process starts with the identification of the significant financial and operational risks applying at TfL with reference to:
- our cumulative knowledge of TfL;
  - planning guidance issued by the Audit Commission;
  - the specific results of previous and ongoing audit work;
  - interviews with TfL officers;
  - liaison with internal audit; and
  - the results of other review agencies' work where relevant.
- 26 KPMG's risk assessment at this stage is based on the results of their 2006/07 audit and work carried out to date in 2007/08. Other specific risks may not become apparent until after they have completed their 2007/08 audit. At this stage KPMG are aware of the following risks that are likely to impact on the audit of the financial statements:

**Table 2 Summary of opinion risks**

| Opinion risks                                                                                                                                | Response                                                                                                                                                                                                                                                                                                                                                                                               |
|----------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| The composition of the TfL Group is expected to change in 2008/09 with the addition of the Metronet companies, Rail for London and Crossrail | KPMG will continue to work with TfL to ensure that the accounting treatment for the consolidation of these entities is in line with the Statement of Recommended Practice<br><br>KPMG will expand their group audit procedures to cover the financial statements of these new entities for 2008/09. This will include accounting implications for the 2007/08 accounts as well as the 2008/09 accounts |
| Changes to the IM environment, for example, upgrade of the SAP system                                                                        | KPMG will work with TfL to ensure their audit approach is risk focussed and takes account of changes introduced during the year                                                                                                                                                                                                                                                                        |

| Opinion risks                                                                                                                | Response                                                                                                                                                                                                                                                                                                                                                  |
|------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| TfL has a significant investment programme aligned to its business plan and has assessed the associated funding requirements | KPMG will continue to assess the development and implementation of robust processes for monitoring and controlling the increased levels of capital investment and borrowing.                                                                                                                                                                              |
| Adoption of IFRS                                                                                                             | The adoption of International Financial Reporting Standards (IFRS) is not required by local government bodies until 2010/11. However, there is a requirement to prepare whole of government accounts (WGA) consolidation packs on the basis of IFRS. KPMG will continue to work with TfL to ensure that TfL is fully prepared for the conversion to IFRS. |

- 27 For each of the significant risks identified in relation to the use of resources work, KPMG consider the arrangements put in place by TfL to mitigate the risk, and plan their work accordingly.
- 28 As Crossrail is expected to become a 100% owned subsidiary of TfL/TTL in September 2008, KPMG will need to discuss the external audit arrangements in respect of Crossrail with TfL management at an early stage. They will need to ensure that appropriate audit arrangements are in place to enable them to issue their group audit opinions at TfL and TTL sub-group levels.
- 29 KPMG have already started to consider the accounting for the two new Metronet companies in 2007/08 and will continue to discuss with management the scope of work to be performed on these companies during 2008/09, including working with Internal Audit on the assessment of key financial controls in place.

## Reliance on Internal Audit

- 30 KPMG have reviewed the Internal Audit plan for 2008/09 and have identified how the work of Internal Audit will impact on their audit approach during the year. They have categorised this into three areas: reviews where they plan to rely on the work of internal audit; reviews where they plan to work jointly with Internal Audit; and reviews which will inform their audit approach.
- 31 There are two specific reviews which KPMG plan to rely on for the purposes of the external audit for 2008/09. These are 'Controls over physical payment processes at the Financial Services Centre' and 'Treasury Management'. KPMG will liaise with Internal Audit on the timing of these reviews.
- 32 There are a number of reviews over the financial processes at Metronet where KPMG propose to work jointly with Internal Audit. KPMG plan to discuss the scope and timing of these audits with Internal Audit in April 2008. In addition, they will continue to liaise with TfL's IT auditors on the IM systems and strategy reviews where appropriate.
- 33 KPMG will also liaise with Internal Audit on arrangements relating to Crossrail as these develop during the forthcoming year.
- 34 There are a number of reviews which are scheduled to be performed across the year which will inform KPMG's accounts audit approach and assessment of TfL's arrangements over its Use of Resources. These span across the group and relate to specific risks. The reviews related to financial health checks, procurement, risk management, contract management, partnership governance and claims management.

## Work specified by the Audit Commission

### Whole of government accounts (WGA)

- 35 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. The 2008/09 WGA consolidated pack will need to be produced in accordance with International Financial Reporting Standards (IFRS).

### National Fraud Initiative (NFI)

- 36 TfL participates in the National Fraud Initiative, which is the Audit Commission's computerised data matching exercise designed to detect fraud perpetrated against public bodies. This work will be carried out by an individual appointed to assist in the audit of the Council's accounts (in accordance with section 3(9) of the Audit Commission Act 1998).

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## Certification of grant claims and returns

37 KPMG will continue to certify the TFLs claims and returns on the following basis:

- claims below £100,000 will not be subject to certification;
- claims between £100,000 and £500,000 will be subject to a reduced, light-touch certification; and
- claims over £500,000 will be subject to a certification approach relevant to the auditor's assessment of the control environment and management preparation of claims. A robust control environment would lead to a reduced certification approach for these claims.

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## The audit and inspection fee

- 38 The details of the structure of scale fees are set out in the Audit Commission's work programme and fee scales 2008/09. Scale fees are based on a number of variables, including the type, size and location of the audited body.
- 39 The fee proposals for 2007/08 are set out in Appendix 1.
- 40 The total proposed audit fee for 2008/09 is £383,500 compared to £380,000 for 2007/08.
- 41 The total inspection fee (payable to the Audit Commission) for 2008/09 is £36,200 compared to £26,500 for 2007/08.
- 42 In addition we estimate that we will charge approximately £15,500 for the certification of claims and returns.

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## Other information

### The audit and inspection team

- 43 The key members of the audit and inspection team for the 2008/09 audit are shown in the table below.

**Table 3**

| Name                                                   | Contact details                                                                                       | Responsibilities                                                                                                                                                                                             |
|--------------------------------------------------------|-------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Ken Davis<br>Relationship<br>Manager                   | <a href="mailto:k-davis@audit-commission.gov.uk">k-davis@audit-commission.gov.uk</a><br>020 7166 2815 | The primary point of contact with TfL and the interface at the local level between the Commission and other key stakeholders.                                                                                |
| June Awty<br>Appointed Auditor<br>(KPMG LLP)           | <a href="mailto:june.awty@kpmg.co.uk">june.awty@kpmg.co.uk</a><br>020 7311 1769                       | Responsible for the overall delivery of the audit including the quality of outputs, signing the opinion and conclusion, and liaison with the Transport Commissioner, Chief Officers and the Audit Committee. |
| Greg McIntosh<br>Director<br>(KPMG LLP)                | <a href="mailto:greg.mcintosh@kpmg.co.uk">greg.mcintosh@kpmg.co.uk</a><br>020 731 6430                | Advises on technical accounting and auditing issues and manages CIPFA and Audit Commission liaison                                                                                                           |
| Ross Tudor<br>Senior Audit<br>Manager (KPMG<br>LLP)    | <a href="mailto:ross.tudor@kpmg.co.uk">ross.tudor@kpmg.co.uk</a><br>020 7311 4251                     | Manages and co-ordinates the different elements of the audit work                                                                                                                                            |
| Marion Follis<br>Senior Audit<br>Manager (KPMG<br>LLP) | <a href="mailto:marion.follis@kpmg.co.uk">marion.follis@kpmg.co.uk</a><br>020 7311 6387               | Responsible for the delivery of the different elements of the audit work                                                                                                                                     |

## Independence and objectivity

- 44 We are not aware of any relationships that may affect the independence and objectivity of the Appointed Auditor and the audit staff, which we are required by auditing and ethical standards to communicate to you.
- 45 We comply with the ethical standards issued by the APB and with the Commission's requirements in respect of independence and objectivity as summarised at Appendix 2.

## Quality of service

- 46 We are committed to providing you with a high quality service. If you are in any way dissatisfied, or would like to discuss how we can improve our service, please contact the Relationship Manager or Appointed Auditor in the first instance.
- 47 If we are unable to satisfy your concerns, you have the right to make a formal complaint to the Audit Commission. The complaints procedure is set out in the leaflet *Something to Complain About* which is available from the Commission's website or on request.

## Planned outputs

- 48 Our reports will be discussed and agreed with the appropriate officers before being issued to the Audit Committee.

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**Table 4**

| Planned output                                                     | Indicative date |
|--------------------------------------------------------------------|-----------------|
| Report on financial statements to those charged with governance    | June 2009       |
| Opinion on the financial statements and value for money conclusion | July 2009       |
| Data quality report                                                | October 2008    |
| Annual audit and inspection letter                                 | TBC             |
| Use of resources report                                            | December 2008   |

## Appendix 1 – Audit and inspection fee

- 49 Table 5 provides details of the planned audit and inspection fee for work to be carried out in 2008/09 with a comparison to the planned fee for 2007/08.

**Table 5**

| Audit area                          | Planned fee 2008/09<br>£ | Planned fee 2007/08<br>£ |
|-------------------------------------|--------------------------|--------------------------|
| Audit                               |                          |                          |
| Financial statements                | 265,500                  | 265,500                  |
| Use of resources                    | 83,500                   | 82,000                   |
| Data quality                        | 29,000                   | 28,000                   |
| Whole of government accounts        | 5,500                    | 4,500                    |
| Total audit fee                     | 383,500                  | 380,000                  |
| Total inspection fee                | 36,200                   | 26,500                   |
| Total audit and inspection fee      | 419,700                  | 406,500                  |
| Certification of claims and returns | 15,500                   | 15,000                   |

- 50 The proposed fee for the financial statements audit includes an inflationary increase of 5% and a similar percentage reduction in respect of anticipated accounts and audit efficiencies to be achieved in 2008/09. This is the same approach as that adopted in 2007/08.
- 51 The proposed fee for the financial statements audit excludes at this stage additional audit work which will be required in respect of new group entities (as set out on page 8). It should be noted that International Auditing Standard 600 (ISA 600 'Using the work of another auditor'), introduced in late 2007 prescribes certain audit procedures which group auditors must follow when relying on work carried out on subsidiary entities or components of a group by other auditors. Much of the additional audit work required on new group entities will be carried out for the audit of the TTL group, but there will also be an impact on the TfL group audit.

- 52 There will also be additional audit time incurred in 2007/08 and in 2008/09 in reviewing proposed accounting treatments in respect of acquisition of these new businesses and accounting within these entries. Work in respect of the Metronet entities has already commenced so there will be additional fees incurred in 2007/08 in this respect.
- 53 We understand that the planned project to review all roles / transactions available to SAP users will not commence until 2008/09. This review was originally intended to be completed in 2007/08. Until this review is completed, we will need to continue to perform additional work to obtain assurance that there are no material misstatements as a result of weaknesses in the control environment.
- 54 The proposed fee also excludes any advice that we may be required to provide in relation to the adoption of IFRS. In particular, the return for the Whole of Government Accounts for 2008/09 will need to be prepared in accordance with IFRS, and the fee of £5,500 quoted above does not yet take into account the cost of time required to audit the IFRS adjustments.
- 55 The fee (plus VAT) will be charged in 12 equal instalments from April 2008 to March 2009.

## Assumptions

- 56 In setting the fee, we have assumed that:
- the level of risk in relation to the audit of the financial statements is not significantly different from that identified for 2007/08, except in respect of new group entities;
  - you will inform us of significant developments impacting on our audit;
  - internal audit meets the appropriate professional standards;
  - good quality working papers and records will be provided to support the financial statements by the first day of the accounts pack audits;
  - requested information will be provided within agreed timescales;
  - prompt responses will be provided to draft reports; and
  - additional work will not be required to address questions or objections raised by local government electors.
- 57 Where these assumptions are not met, we may be required to undertake additional work which is likely to result in an increased audit fee..
- 58 Changes to the plan will be agreed with you. These may be required if:
- new audit risks emerge;
  - additional work is required of us by the Audit Commission or other regulators; and
  - additional work is required as a result of changes in legislation, professional standards or as a result of changes in financial reporting.

## Process for agreeing any changes in audit fees

- 59 If we need to amend the audit or inspection fees during the course of this plan we will firstly discuss this with the Chief Finance Officer. We will then prepare a report outlining the reasons why the fee needs to change for discussion with the Audit Committee.

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## Appendix 2 – Independence and objectivity

- 1 Auditors appointed by the Audit Commission are required to comply with the Commission's Code of Audit Practice and Standing Guidance for Auditors, which defines the terms of my appointment. When auditing the financial statements auditors are also required to comply with auditing standards and ethical standards issued by the Auditing Practices Board (APB).
- 2 The main requirements of the Code of Audit Practice, Standing Guidance for Auditors and the standards are summarised below.
- 3 International Standard on Auditing (UK and Ireland) 260 (Communication of audit matters with those charged with governance) requires that the appointed auditor:
  - discloses in writing all relationships that may bear on the auditor's objectivity and independence, the related safeguards put in place to protect against these threats and the total amount of fee that the auditor has charged the client; and
  - confirms in writing that the APB's ethical standards are complied with and that, in the auditor's professional judgement, they are independent and their objectivity is not compromised.
- 4 The standard defines 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case, the appropriate addressee of communications from the auditor to those charged with governance is the audit committee. The auditor reserves the right, however, to communicate directly with the authority on matters which are considered to be of sufficient importance.
- 5 The Commission's Code of Audit Practice has an overriding general requirement that appointed auditors carry out their work independently and objectively, and ensure that they do not act in any way that might give rise to, or could reasonably be perceived to give rise to, a conflict of interest. In particular, appointed auditors and their staff should avoid entering into any official, professional or personal relationships which may, or could reasonably be perceived to, cause them inappropriately or unjustifiably to limit the scope, extent or rigour of their work or impair the objectivity of their judgement.

6 The Standing Guidance for Auditors includes a number of specific rules. The key rules relevant to this audit appointment are as follows:

- Appointed auditors should not perform additional work for an audited body (ie work over and above the minimum required to meet their statutory responsibilities) if it would compromise their independence or might give rise to a reasonable perception that their independence could be compromised. Where the audited body invites the auditor to carry out risk-based work in a particular area that cannot otherwise be justified as necessary to support the auditor's opinion and conclusions, it should be clearly differentiated within the audit plan as being 'additional work' and charged for separately from the normal audit fee;
- auditors should not accept engagements that involve commenting on the performance of other auditors appointed by the Commission on Commission work without first consulting the Commission;
- the Appointed Auditor responsible for the audit should, in all but the most exceptional circumstances, be changed at least once every five years;
- the Appointed Auditor and senior members of the audit team are prevented from taking part in political activity on behalf of a political party, or special interest group, whose activities relate directly to the functions of local government or NHS bodies in general, or to a particular local government or NHS body; and
- the Appointed Auditor and members of the audit team must abide by the Commission's policy on gifts, hospitality and entertainment.

