



Date: 1 October 2013

Item 7: Policy on External Audit and Non Audit Services to Safeguard the Independence of External Auditors

This paper will be considered in public

1 Summary

- 1.1 To present the draft revised Policy on External Audit and Non audit Services the Audit and Assurance Committee for consideration. The current draft of the policy is attached to this paper.
- 1.2 The revised policy will also be presented to the Audit Committees of Crossrail Limited and London Transport Museum Limited.

2 Recommendation

- 2.1 **The Committee is recommended to approve the revised Policy.**

3 Background

- 3.1 The policy requires the approval of the Audit and Assurance Committee. The policy was last updated in 2009, and has been revised in line with good practice from large quoted companies.
- 3.2 The External Audit Services Policy was first established in 2003 to apply the Audit Commission's rules on independence for the external auditors appointed by them to TfL Corporation to all of the subsidiary companies of TfL for consistency. KPMG, as auditors of TfL, report on their compliance with this policy twice a year.
- 3.3 The policy was updated in 2009 to reflect changes in Audit Commission rules.
- 3.4 The policy has now been revised to provide additional guidance on the types of work that it is acceptable for the external auditor to undertake, and to provide clarity on the process to be followed for approval.
- 3.5 The policy seeks to define services that the auditor may not undertake in any circumstances, and also defines audit related services which are likely to be less contentious and therefore subject to a simpler approval mechanism.
- 3.6 For non audit services, a detailed approval process is set out, requiring Committee involvement in certain cases.

- 3.7 The policy also reflects the latest Audit Commission requirements for approvals.
- 3.8 KPMG LLP has been appointed auditors of TfL by the Audit Commission for a five year period commencing from 1 April 2012. The arrangements for appointing auditors for the period subsequent to this term have not yet been finalised. Once the regulations and procedures for tendering of audits at the end of this term are published, TfL will reconsider its policy for the tendering of its external audit.

List of appendices to this report:

Appendix 1 – Draft External Audit Services Policy

Appendix 2 – Existing External Audit Services Policy, approved 2009

List of Background Papers:

None

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Transport for London

Policy on External Audit and Non-Audit Services to Safeguard the Independence of External Auditors

1. Background

1.1 Transport for London (“TfL”) is committed to ensuring that the financial statements of the Group, the Corporation and relevant subsidiaries have an effective and independent annual audit by its external auditors. Under Standing Orders and the Subordinate Bodies of TfL document, the Board has delegated to the Audit and Assurance Committee responsibility for certain aspects of the relationship with external auditors.

1.2 The responsibilities as set out in the Subordinate Bodies document include:

- To meet with the External Auditors before the audit commences to review audit plans and scope
- To review the Annual Report and Accounts, the Annual Audit Letter and other external reports and to discuss these with the External Auditors
- To review the effectiveness of the External Auditors after each statutory audit
- To review the independence and objectivity of the External Auditors
- To meet the External Auditors at least annually without any Officer being present
- To develop and implement policy on the engagement of the External Auditors to supply non-audit services

2. Purpose and objectives

2.1 This policy sets out TfL’s policies and procedures to fulfil the responsibilities of the Committee relating to the external auditors, including for the engagement of the external auditors on non audit related assignments. It also sets out the requirements for the pre-approval and reporting of fees for non audit services.

2.2 All entities in the TfL Group are required to conform to this policy.

3. Appointment of External Auditors

3.1 Responsibility for the appointment of TfL’s external auditors lies with the Audit Commission.

3.2 The auditors of TTL are appointed in line with the requirements of the Companies Act and is the responsibility of TfL management under the supervision of the Chief Finance Officer (‘CFO’). There are potential benefits to TfL in having a single firm of

auditors responsible for the audits of TfL (under the Audit Commission framework) and of TTL and its subsidiaries. These potential benefits will be taken into account in any tendering process to ensure that overall value for money is achieved.

4. Audit Plan and Fees

4.1 The scope of the annual audit of the financial statements will be presented to, discussed with, and agreed by the Audit and Assurance Committee. The external audit plan shall include the identification of key risks and the audit approach to be adopted to address such risks. It shall also include the audit cycle and confirm the deliverables, including reporting to the Committee. The Committee shall approve the proposed fees for the audit of TTL and its subsidiaries. As noted above the annual audit fee for TfL is set by the Audit Commission, while the fee for the TTL entities is subject to negotiation with TfL management.

5. Rotation of Audit Partners and Staff

5.1 The lead audit engagement partner for TfL will be appointed for a period of up to five years (which is the maximum period allowed by the Auditing Practices Board's ('APB') regulations). This period may only be extended following consultation with the Audit and Assurance Committee and the Audit Commission and a consideration of all relevant rules and regulations regarding rotation of audit partners which may exist at that time.

5.2 The audit senior manager for TfL needs to be changed at least every ten years, other than in exceptional circumstances. Where the manager becomes the senior responsible auditor e.g. the audit partner, he/she may serve in that role for up to five years. Extensions of this period will be approved in the same manner as set out in 4.1 above. The maximum combined continuous period of service as audit manager and lead audit engagement partner may not, however, exceed ten years.

5.3 The terms to be served by the audit engagement partner and manager for TTL and any of its subsidiaries should comply with the rules and regulations which exist for rotation at that point in time (e.g. the APB's Ethical Standard 5 ('APB ES 5')). The TTL partner is considered a key audit partner under the current APB guidance and as such may remain in post for a period of 7 years.

6. Meetings between Auditors and the Audit and Assurance Committee

6.1 The auditors should raise directly with the Chair or members of the Committee any matters of concern that they have in relation to their audit responsibilities where they believe that the concerns have not been adequately addressed through the regular processes established with management. Separate meetings of the auditors and Committee members, without Officers present, will be held not less than once per year. The auditors may also request at any time such a separate meeting with the Committee.

7. Evaluation of the Performance of the External Auditors

- 7.1 The Audit and Assurance Committee will review the performance of the external auditors following the completion of each statutory audit. This review will cover the performance of the external auditors across all parts of the TfL Group.
- 7.2 Where issues are identified regarding the performance of the external auditors these will normally be addressed directly through communication between the Chief Finance Officer and the external audit partner. In cases, however, where the performance of the external auditor is considered to be seriously or consistently below standard the Audit and Assurance Committee may request the Chief Finance Officer to take steps to remove the external auditors from office. Removal of TfL's auditors is not directly within the power of TfL Management, but can be influenced by submission of a written request to the Audit Commission. The auditors of TTL may be removed directly by the directors of those companies, but only after consultation with the TfL Audit and Assurance Committee.

INDEPENDENCE AND THE PROVISION OF NON AUDIT SERVICES

8. Auditor Independence

- 8.1 Audit services are defined as follows:
- for TfL, the services required to meet the Audit Commission Code of Practice requirements.
 - for TTL, the work required to enable the external auditor to issue an audit opinion on the company's annual accounts in accordance with the Companies Act
- 8.2 An important element of good corporate governance is the independence of the external auditors. Within certain parameters, the Group's external auditors can be used for certain non audit services. However, independence may be perceived as being compromised if the non audit services carried out by the Group's auditors are extensive.
- 8.3 External auditors, or any firm with which the auditor is associated, should not therefore carry out work that does not relate directly to the discharge of audit functions, if it would impair the auditors' independence, or might give rise to a reasonable perception that their independence could be impaired.
- 8.4 The purpose of this policy is to ensure a consistent approach across all parts of the TfL Group to the approval of non-audit services to be undertaken by the external auditors.
- 8.5 The process to be followed will depend on the nature of the work to be undertaken. There are two categories of work that may be undertaken by the external auditors, namely audit related services and other permitted services, and separate processes for each are set out below.

9. Prohibited services

- 9.1 Under the TfL policy of auditor independence, the external auditor may not provide prohibited services.
- 9.2 Prohibited services include those services where an adviser is making judgments or taking decisions that are the responsibility of management, including the following:
- bookkeeping services
 - financial information systems design and implementation
 - a valuation that has a material effect on the financial statements
 - tax services involving tax structures or products that depend for their effectiveness on a particular accounting treatment
 - executive recruiting and human resource services
 - actuarial services
 - management functions including secondments to management positions that include decision making
 - management of, or significant involvement in, internal audit services
 - any other work that is prohibited by UK ethical guidance.
- 9.3 Other examples of services that may be deemed to be prohibited include:
- material commercial structuring assignments, where the adviser is both commenting on proposed structures and advising on potential alternatives, including commenting on commercial implications of structures and potential accounting treatments.

Services of this nature will be considered on a case by case basis, but there are likely to be additional considerations with regard to public perception and independence where the structuring assignment/project is material to TfL and where the external auditor is also bidding to engage in such an advisor role.

- 9.4 Where such services are being contemplated by the external auditors, they should seek the approval of the CFO and award will be in accordance with paragraph 12 [Award of Permitted Services] and paragraph 13 [Financial Threshold for Audit Related Services and Permitted Services]

10. Audit Related Services and their Award

- 10.1 Audit related services are assurance services or other work traditionally provided by the external auditors. They usually result in a certification or specific opinion on an investigation and may include:

- internal control reviews – review of internal controls related to specific operations and/or business processes e.g. general IT controls.
- additional assurance requested by individual businesses on processes or controls that fall outside the scope of the TfL audit due to materiality levels.
- issuance of comfort letters – issuance of comfort letters in respect of information provided to third parties including bond issues.
- consultation regarding accounting policies – discussion and review of the impact of new accounting pronouncements and accounting for one-off transactions.
- work associated with Electors’ enquiries.
- grant claim certification.
- Rail Settlement Plan clearance agreement review.
- other work of a similar nature

10.2 The external auditors are required to seek approval from the CFO in advance of starting work on an assignment falling within the category of “audit related services”.

10.3 Awards of audit related services are to be made in accordance with the financial threshold and approval process set out in paragraph 13 below.

11. Permitted Services

11.1 All services, other than those falling within the categories of audit related services or prohibited services above, are classified as “permitted services”.

11.2 Awards of permitted services are to be made in accordance with paragraphs 12 and 13 below.

12. Award of Permitted Services

12.1 The external auditors may decide to bid for permitted services assignments that are put out for tender, bearing in mind the financial threshold and approval process set in 13 below. They are responsible for ensuring they do not bid for projects proscribed by APB ES 5.

12.2 It is recognised that there will be some items of non-audit work that the external auditors are best placed to deliver because of the knowledge or experience gained through the audit process. Any decision to award permitted services to the external auditors without going out to tender must be taken by the relevant Managing Director with the agreement of the CFO and in accordance with TfL’s ‘single source procurement’ rules. The financial threshold and approval process set out in 13 below also apply.

12.3 Irrespective of the procurement process followed, the external auditors are required to seek approval from the CFO in advance of starting work on an assignment falling within the category of “permitted services”.

13. Financial Threshold for Audit Related Services and Permitted Services

13.1 The threshold for requiring the approval of the Committee for audit related services and permitted services provided by the auditors to TfL Group entities will be the higher of £150,000 and 10 per cent of the Group audit fee, based on the total statutory audit fee proposed (“the threshold”).

13.2 The CFO can approve any individual assignment within these categories up to the threshold. In addition, the CFO may, at his discretion, discuss the award with the Chair of the Audit and Assurance Committee.

13.3 Where the fee for an individual assignment exceeds the threshold, the CFO is required to consult with the Chair of the Audit and Assurance Committee who will decide whether the Committee needs to approve the appointment in advance of the work commencing.

13.4 Irrespective of the financial threshold above, if there is any doubt as to whether the external auditors have a conflict of interest, approval by the Audit and Assurance Committee is required.

13.5 The Chair of the Audit and Assurance Committee should be informed once the total of fees for audit related services and permitted services is expected to exceed 20% of the Group audit fee in any given financial year.

14. Record Keeping

14.1 The external auditors will be responsible for maintaining detailed records of all non-audit work undertaken and for ensuring they do not undertake any of the work proscribed above. They will be responsible for advising the relevant Managing Director and the CFO if a request for them to undertake non-audit work will result in the limits set by the Audit and Assurance Committee being exceeded.

15. Reporting on Non Audit Fees

15.1 All non-audit work will be reported six monthly to the Audit and Assurance Committee by the external auditors as a standing agenda item.

16. Independence Reporting

16.1 The external auditors are requested to confirm their independence in writing at the meeting where they present the external audit plan, and at the meeting where the results of the audit are reported prior to the audit opinion being finalised.

17. Audit Commission Requirements

17.1 The Audit Commission imposes restrictions over and above those set out by the APB ES 5 on the nature and extent of the non-audit work which external auditors of local authorities are allowed to undertake for an audit client. In particular, external auditors

must seek Audit Commission approval to carry out non-audit work for TfL where the fees exceed the higher of £18,000 or 20 per cent of the agreed TfL audit fee. This is solely for non audit services that are engaged directly by TfL, and the threshold is based on the audit fee for TfL set by the Audit Commission (see 3.1 above). The de minimis amount is applied cumulatively, so that approval must be obtained from the Audit Commission if the value of the work, individually or in total in any financial year, will exceed that amount.

- 17.2 They also should not carry out work that does not relate directly to the discharge of auditors' functions if it would impair the auditors' independence, or might give rise to a reasonable perception that their independence could be impaired.
- 17.3 These restrictions also apply to additional work proposed to be undertaken at affiliates of TfL, where the affiliate's external auditors are appointed by the Audit Commission. The restrictions do not apply in respect of additional work undertaken for TfL's subsidiary companies (eg where the services are procured directly by TfL or any of the TfL subsidiaries)
- 17.4 The external auditors must also notify the Audit Commission of any fee variations to the fee set for the TfL Corporation, including any changes to scope (e.g. new accounting/auditing standards) or any overruns incurred in performing the external audit. In such circumstances any fee variations are discussed and agreed in advance with TfL management subject to Audit Commission approval, and shall be presented to the Audit and Assurance Committee at the next relevant meeting.

18. Responsibilities

- 18.1 Managing Directors are responsible for:
- ensuring single source procurement rules are followed when the external auditors are awarded non-audit work on the grounds they are best placed to do the work.
 - Obtaining the agreement of the CFO when they wish to award audit related services or permitted non-audit work to the external auditors.
- 18.2 The external auditors are responsible for:
- maintaining detailed records of all non-audit work undertaken.
 - ensuring they do not undertake any proscribed work and seeking permission to perform non-audit work where required by this policy.
 - advising the CFO of all proposed non-audit work and also where the fees for non-audit work, other than fees for audit related services, will result in the fee limits set by the Audit and Assurance Committee being exceeded.
 - reporting all non-audit work to the Audit and Assurance Committee every six months.
 - seeking and obtaining Audit Commission approval to carry out non-audit work where required.

18.3 The Chief Finance Officer is responsible for:

- recommending the appointment of external auditors for TTL.
- liaising as appropriate with the Audit Commission on the appointment and performance of the external auditors for TfL.
- ensuring that the Audit and Assurance Committee is provided with the information that it needs to carry out its annual review of the performance of the external auditors.
- reviewing all proposals to engage external auditors to carry out non-audit work and liaising with the Chair of the Audit and Assurance Committee as required by this policy.
- reviewing this policy on an annual basis to ensure it remains appropriate and consistent with the applicable regulatory and Audit Commission guidance.
- if the Chief Finance Officer is unavailable, the Managing Director Finance is his alternate for the purposes of this policy.

Transport for London

Policy on External Audit Services

1 Introduction

- 1.1 Under the local government regime applicable to TfL (including London Streets and the Public Carriage Office) responsibility for the appointment of TfL's external auditors lies with the Audit Commission. Under the Audit Commission's rules external auditors are appointed for an initial period of five years, although this term is extendable. Where a term is extended the Audit Commission requires the audit partner to rotate at least once in every five years and the audit manager to rotate at least once every seven years, in all but the most exceptional circumstances. The Audit Commission does rotate audits between suppliers from time to time to ensure that too close a relationship is not developed.
- 1.2 The Audit Commission also imposes restrictions on the extent to which external auditors of local authorities are allowed to carry out non-audit work for an audit client. In particular, external auditors must seek Audit Commission approval to carry out non-audit work where the fees exceed the higher of £30,000 or 20% of the agreed audit fee. They also should not carry out work that does not relate directly to the discharge of auditors' functions, if it would impair the auditors' independence, or might give rise to a reasonable perception that their independence could be impaired.
- 1.3 None of the restrictions noted above are applicable to the external auditors of TTL or its subsidiaries ('TTL'), who are appointed in accordance with the Companies Act.
- 1.4 The purpose of this policy is to ensure that a consistent approach is taken to the appointment of external auditors across all parts of the TfL Group.

2 Policy

2.1 *Appointment and Rotation of External Auditors*

- 2.1.1 As noted above, the Audit Commission appoints TfL's external auditors for a five-year term, although this may be extended. Whenever the Audit Commission indicates its intention to change TfL's auditors, TTL's directors should consider whether to initiate a tendering process for the audit of TTL. If the auditors of TTL have been in office for at least five years then a tendering process will automatically be considered. The directors may, of course, choose to retender the audit of TTL at any time. The Chief Finance Officer will be responsible for the tendering process and for recommending external auditors as a result of that process to the TTL Board.
- 2.1.2 In circumstances where TTL has retained the same auditors for a period of seven years the directors of TTL will, in accordance with this policy, require the Audit Partner and Manager to be rotated.
- 2.1.3 The Terms of Reference of the TfL Audit Committee, as set out in TfL Standing Orders require the Committee to review the performance of the external auditors following the

completion of each statutory audit. This review will cover the performance of the external auditors of all parts of the TfL Group.

2.1.4 Where issues are identified regarding the performance of the external auditors these will normally be addressed directly through communication between the Chief Finance Officer and the external audit partner. In cases, however, where the performance of the external auditor is considered to be seriously or consistently below standard the Audit Committee may request the Chief Finance Officer to take steps to remove the external auditors from office. Removal of TfL's auditors is not directly within the power of TfL Management, but can be influenced by submission of a written request to the Audit Commission. The auditors of TTL may be removed directly by the directors of those companies.

2.2 *Non Audit Work*

2.2.1 Audit services are defined as follows:

- for TfL the services required to meet the Audit Commission Code of Practice requirements.
- for TTL the work required to enable the external auditor to issue an audit opinion on the company's annual accounts in accordance with the Companies Act.

2.2.2 External auditors, or any firm with which the auditor is associated, should not carry out work that does not relate directly to the discharge of auditors' functions, if it would impair the auditors' independence, or might give rise to a reasonable perception that their independence could be impaired.

2.2.3 The Audit Committee will determine the threshold above which permission to perform non audit work needs to be obtained from the Audit Committee. The maximum threshold for the TfL Group under the Audit Commission rules will be the higher of 20 per cent of the audit fee, based on the total statutory audit fee proposed, or £30,000 (statutory audit services are, for TfL, services required to meet the Audit Commission's Code of Audit Practice requirements and, for TTL and its subsidiaries, services required to enable the external auditor to issue an audit opinion on the annual accounts in accordance with the Companies Act). For the avoidance of doubt, there will be no restriction to the level of non-statutory audit work (audit work performed outside the definition of statutory audit services, such as work on grant claims and returns where an audit certificate is required as a condition of the grant scheme) that the external auditors can undertake.

2.2.4 The external auditors may decide to bid for non-audit work that is put out for tender bearing in mind the financial threshold and approval process set in 2.2.3. They are responsible for ensuring they do not bid for proscribed activities.

2.2.5 It is recognised that there will be some items of non-audit work that the external auditors are best placed to deliver because of the knowledge or experience gained through the audit process. Any decision to award work to the external auditors without going out to tender must be taken by the relevant Managing Director with the agreement of the Chief Finance Officer and in accordance with TfL's 'single source procurement' rules.

- 2.2.6 Where the award of work under 2.2.5 falls within the financial threshold set in 2.2.3, the Managing Director and Chief Finance Officer may, at their discretion, discuss the award with the Chair of the Audit Committee.
- 2.2.7 Where the award of work under 2.2.5 exceeds the financial threshold set in 2.2.3, or takes the total of non audit work over the limit, the Chief Finance Officer must consult with the Chair of the Audit Committee who will decide whether the Audit Committee needs to approve the appointment in advance of the work commencing.
- 2.2.8 The external auditors of TfL Corporation must, in addition, seek the approval of the Audit Commission to carry out any non-audit work in TfL that will exceed the higher of £30,000 or 20 per cent of the total agreed audit fee for the TfL Corporation only.
- 2.2.9 The external auditors will be responsible for maintaining detailed records of all non audit work undertaken and for ensuring they do not undertake any of the work proscribed above. They will be responsible for advising the relevant Managing Director if a request for them to undertake non audit work will result in the limits set by the Audit Committee being exceeded. All non audit work will be reported six monthly to the Audit Committee by the external auditors as a standing agenda item.

3 Responsibilities

- 3.1 Managing Directors are responsible for
- ensuring single source procurement rules are followed when the external auditors are awarded non-audit work on the grounds they are best placed to do the work.
 - obtaining the agreement of the Chief Finance Officer when they wish to award non-audit work to the external auditors which will result in the financial limits set by the Audit Committee being exceeded.
- 3.2 The external auditors are responsible for
- maintaining detailed records of all non-audit work undertaken.
 - ensuring they do not undertake any proscribed work.
 - advising the relevant Chief Officer if a request for them to undertake non audit work will result in the limits set by the Audit Committee being exceeded.
 - reporting all non audit work to the Audit Committee every six months.
- 3.3 The Chief Finance Officer is responsible for:
- recommending the appointment of external auditors for TTL.
 - liaising as appropriate with the Audit Commission on the appointment and performance of the external auditors for TfL.

- ensuring that the Audit Committee is provided with the information that it needs to carry out its annual review of the performance of the external auditors.
- reviewing all proposals to engage external auditors to carry out non audit work and liaising with the Chair of the Audit Committee as required by this policy.