

TRANSPORT FOR LONDON

AUDIT COMMITTEE

**SUBJECT: EXTERNAL AUDIT PLAN TfL, TTL AND SUBSIDIARIES - YEAR
ENDING 31 MARCH 2012**

DATE: 28 SEPTEMBER 2011

1 PURPOSE

- 1.1 To present to the Audit Committee KPMG's plan for the audit of the financial statements of Transport for London, Transport Trading Limited and its subsidiaries for the year ending 31 March 2012.

2 BACKGROUND

- 2.1 The Plan has been developed by the Appointed Auditor, KPMG, and sets out the work that they propose to undertake in the 2011/12 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 RECOMMENDATION

- 3.1 The Audit Committee is asked to note the Plan and to make any comments as appropriate.

4 CONTACT

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cutting through complexity™

Transport for London

Financial Statements Audit Plan 2011-12

September 2011

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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 TTL 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 Wayne Southwood, who is the engagement Partner to TfL, telephone 0207 311 3232, email wayne.southwood@kpmg.co.uk who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 236 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

This document describes how we shall deliver our audit work for the relevant entities for the year ending 31 March 2012.

- 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).
- Our work for 2011-12 shall cover two key areas:
 - Financial statements (including the Annual Governance Statement): providing an opinion on your accounts; and
 - Value for money (VFM).
- We are also the auditors of the TTL Group companies, although this appointment falls outside of the remit of the Audit Commission. For these entities we shall provide a statutory opinion on the Financial Statements.
- Set out below is a high level outline of our proposed work and outputs for these areas. 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 financial statements and associated disclosure notes.
 - We will also review your Annual Governance Statement (AGS) to confirm that it is in line with our understanding of the business
 - For the TfL and TTL Group Accounts we shall review your consolidation process and substantively test journals relating to 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 challenging how TfL secures economy, efficiency and effectiveness.

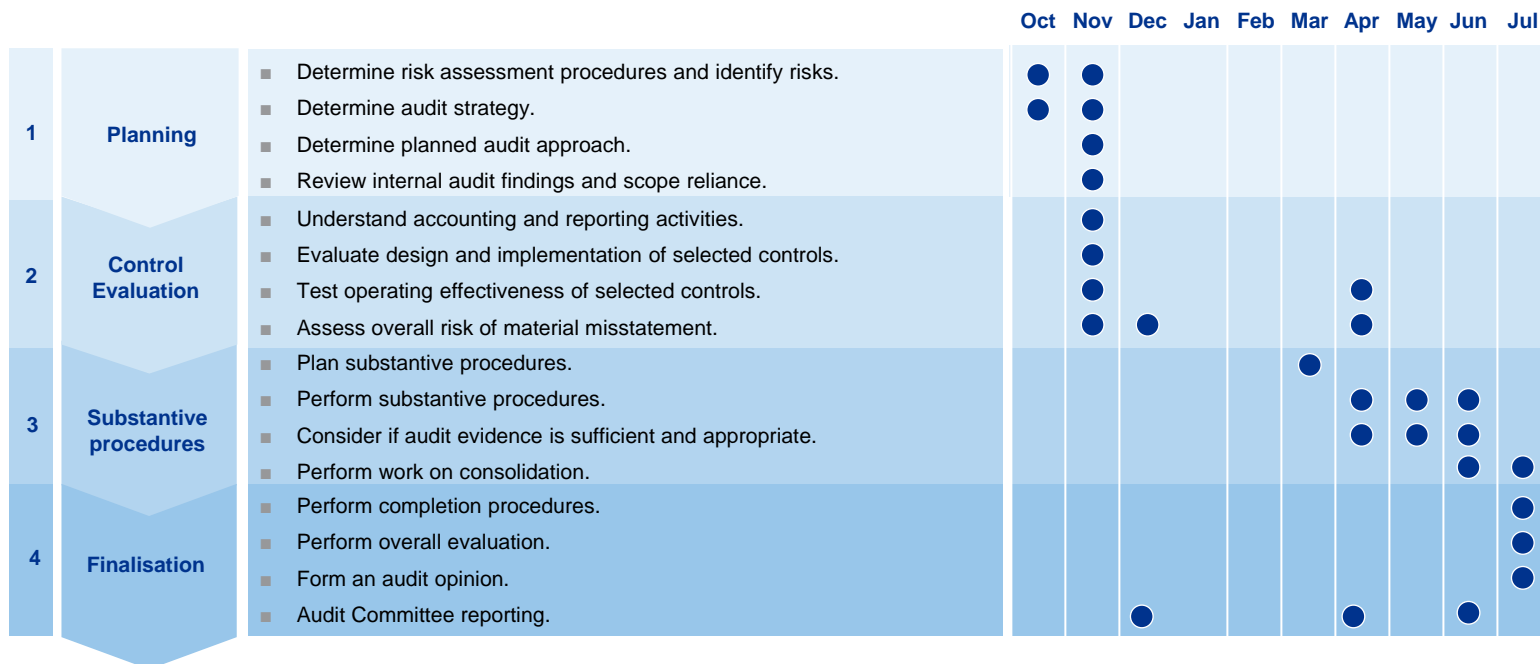
As in the prior year we shall not make annual scored judgements relating to our local VFM audit work. Instead we will report the results of all the local VFM audit work and the key messages for the audited body in our annual report to those charged with governance and in a clear and accessible annual audit letter.

- 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.

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 are required to satisfy ourselves that the accounts of the TfL and TTL Groups comply with statutory requirements (including the Code 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 on 16 subsidiary companies.
- 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 work with your finance team and internal audit team to enhance the efficiency of the financial statements audit.

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 utilise 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 UK Bribery Act 2010 came into force on 1 July 2011. We will meet with Alan Day, Senior Audit & Investigations Manager, to understand TfL's response to the Act.
- 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. For the 2011-12 plan we intend to refer to the following reviews:
 - Cycle Hire;
 - Milestone management;
 - Fraud risks in projects and contracts; and
 - Payroll

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 1 October 2012.

Key financial statement audit risks

Through discussions with officers and our existing TfL and sector knowledge we have identified a number of key financial statement risks.



Note: ● High.
 ● Medium.
 ● Low.




The high risk issues are discussed overleaf.

The size of each bubble is not representative of the scale of the risk.

Key financial statement audit risks

For each key risk we have outlined the impact on our audit plan.




We shall provide an update to the Audit Committee on these risk issues as part of our Report to those charged with Governance in June 2012.

Key audit risks	Impact on audit plan
 <p>Audit areas affected</p> <ul style="list-style-type: none"> All financial statement captions 	<p>A significant amount of work has been completed by TfL in the past year using the SAP GRC tool to evaluate access rights in the SAP ECC system (controls in the general ledger which regulate access rights) and, where required, put in place appropriate restrictions.</p> <ul style="list-style-type: none"> However, our testing in 2010-11 highlighted deficiencies within Accounts Payable, for example: <ul style="list-style-type: none"> the ability of 82 users to maintain Supplier Master data and approve Purchase Orders. the ability of 11 users to process payments and complete Bank Reconciliations. We also identified segregation of duties conflicts within Accounts Receivable, with 103 users having the ability to post credit notes and manage cash application (receipting). We will use our IT specialists to carry out a review of SAP access rights and segregation of duties as part of our interim audit visit.
 <p>Audit areas affected</p> <ul style="list-style-type: none"> Expenditure and creditors Controls 	<ul style="list-style-type: none"> Our work in 2010-11 identified that it was possible and necessary to raise purchase orders (POs) directly onto SAP as opposed to them being processed through the e-procurement module on SAP. We will review the alternative controls in this area and perform additional testing on a sample of these transactions to ensure that they are valid and authorised. Both Crossrail Ltd and Tube Lines Ltd have been the victims of procurement fraud, whereby letters are received purporting to be from genuine suppliers requesting that bank account details are changed. This is becoming an increasingly common fraud across all industries and sectors. With the increased level of activity on Crossrail we will revisit the controls in place over the procurement process. We will review the controls and processes in place across the Group for amending supplier details
 <p>Audit areas affected</p> <ul style="list-style-type: none"> Grants Funding Financial standing 	<ul style="list-style-type: none"> TfL like other local government bodies had its funding reviewed in 2010. The output of this exercise was a funding settlement from the government which set out how much grant and other funding will be received over the next four years along with an outline of the borrowing levels permitted. 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 government 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 will assess TfL's actual and forecast compliance with them.

Key financial statement audit risks (cont.)

For each key risk we have outlined the impact on our audit plan.




We shall provide an update to the Audit Committee on these risk issues as part of our Report to those charged with Governance in June 2012.

Key audit risks	Impact on audit plan
 <p>Audit areas affected</p> <ul style="list-style-type: none"> Financial statement presentation 	<ul style="list-style-type: none"> TfL is required under the LG Code to publish details of all highly paid employees. Given TfL's high profile this information is very sensitive and therefore it is essential that the information is accurate and complete. Salary bandings disclosures are also required for employees of the Corporation earning more than £50,000. This disclosure is only applicable to the Corporation and not the employees of the wider group. Project Horizon (see below) is likely to result in redundancy payments which increase the number of employees in each band. Furthermore, changes to employment contracts will mean more TfL employees are contractually employed by the Corporation, thus increasing the numbers of employees in each salary banding. We will review the process by which this disclosure is generated and will test a sample of employees by agreeing back to P60s and, where relevant, employment and redundancy contracts.
 <p>Audit areas affected</p> <ul style="list-style-type: none"> Provisions Revenue Fixed Assets Purchasing 	<ul style="list-style-type: none"> TfL is currently in the consultation phase of Project Horizon. HR are the first area to undergo reorganisation, and new structures in that area are due to go live in November 2011. It is envisaged that HR will then assist in rolling out new structures for the other workstreams. New structures for non-operational service teams, including finance, are due to be in place by January 2012. As part of Project Horizon it is likely that a redundancy programme will be undertaken which may result in provisions being required at the year end. Roles and responsibilities will change as teams are restructured. Robust project management is essential in managing these changes. Data transfers are anticipated particularly in areas such as purchase ordering. Change control over data will be critical. We will review the progress of Project Horizon and ensure that any necessary provisions are captured and appropriately disclosed and we will report to you any changes we may observe which could have a negative impact on key financial controls. We will perform additional testing as necessary where systems are transferred to ensure controls operate effectively in both periods. Our IT specialists will be engaged to check any data transfers have been performed effectively.
 <p>Audit areas affected</p> <ul style="list-style-type: none"> Funding Borrowing 	<ul style="list-style-type: none"> 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 will review TfL's performance against these prudential indicators as part of our final and interim audit and at the time of signing the accounts we will review the forecast position for the next 12 months, to assure ourselves that the indicators will not be breached.

Key financial statement audit risks (cont.)

For each key risk we have outlined the impact on our audit plan.


We shall provide an update to the Audit Committee on these risk issues as part of our Report to those charged with Governance in June 2012.

Key audit risks	Impact on audit plan
 <p>Audit areas affected</p> <ul style="list-style-type: none"> Provisions, contingent liabilities and accruals 	<ul style="list-style-type: none"> TfL is subject to significant 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. 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 the 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.
 <p>Audit areas affected</p> <ul style="list-style-type: none"> Fixed assets Depreciation 	<ul style="list-style-type: none"> On the majority of projects undertaken within TfL and TTL a judgement 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). 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 under construction. 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. We will also discuss any aborted projects with management and determine how any associated costs have been accounted for. This will include a review of any project re-profiling.
 <p>Audit areas affected</p> <ul style="list-style-type: none"> Investments Hedging Financial statement presentation 	<ul style="list-style-type: none"> TfL have put into place a long term financing plan to issue debt for the period covered by the Spending Review. This year TfL has entered into FX hedging and Gilt Locks and are currently considering restructuring the remaining £930 million of A1 loan notes in Tube Lines (Finance) Plc. We will use our treasury specialists to review these transactions and ensure that they have been appropriately accounted for and disclosed in the financial statements.

Key financial statement audit risks (cont.)

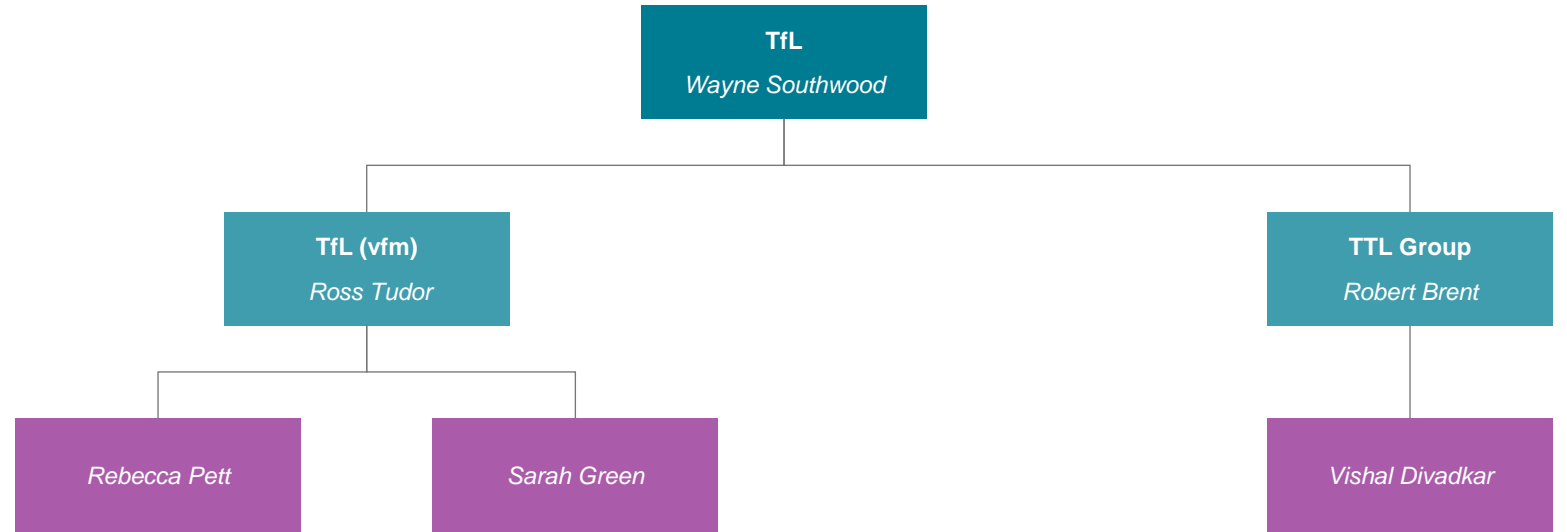
For each key risk we have outlined the impact on our audit plan.

We shall provide an update to the Audit Committee on these risk issues as part of our Report to those charged with Governance in June 2012.

Key audit risks	Impact on audit plan
 <p>Revenue recognition</p> <p>Audit areas affected</p> <ul style="list-style-type: none"> Revenue 	<ul style="list-style-type: none"> A significant proportion of revenue is collected through tube stations. The majority of the balance is collected through newsagents and managed by Cubic. TfL rely on data supplied through this system for recording such revenue in the accounts. Revenue is then allocated between the various operating businesses based on survey data. In the absence of robust reconciliations, there is a risk of manipulation of revenue; this is significantly mitigated by the work of Internal Audit's fraud team. Income from Congestion Charging (CC) and Low Emission Zone (LEZ) is collected and administered through a service provider, IBM. The cycle hire scheme is operated by Serco. In both cases contract management and monitoring controls are key. We will review the controls and processes in place at TfL to ensure that there is appropriate oversight of the contracts as well as perform logic checks on the revenue received from these areas. We will also review cash reconciliations and use our IT colleagues to review the ticketing system.

Key audit team and specialists

Your team will remain largely consistent with the prior year. Contact details are shown on slide 1.



David Prestwich Tax	Umar Mahmood Treasury	Greg McIntosh Local Government	Keith Bannister IT	Naz Peralta Pensions	Will Gray Valuations
			Bryan Altimas , Ben Foulser IT	Ed Brogden Pensions	

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. The standards also place requirements on auditors in relation to integrity, objectivity and independence.
- The ISA 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 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 20 September 2011 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 fee is calculated with reference to a number of factors including your turnover and our assessment of audit risk and control environment.
- We set out our proposed 2011-12 fee for the Corporation and Group in our audit plan fee letter dated 18 February 2011 which was presented to the Audit Committee in June 2011. This fee has been replicated below.

Element of the audit	2011-12 (£)	2010-11 (£)
Corporation/Group Financial Statement Audit	301,000	311,010
Value for Money	43,570	43,570
Whole of Government Accounts	5,500	5,500
Total for TfL Corporation and Group	350,070	360,080
One off IFRS transition fee	nil	280,000

Consistent with prior years the fees in relation to the TTL Group will be tabled at the next meeting of the Audit Committee.

Our audit fee is indicative and based on you meeting our expectations of your support as outlined in Appendix 1.

Meeting these expectations will help the delivery of our audit within the proposed audit fee.

Audit fee assumptions

- The audit fee is indicative and is based on you meeting our agreed expectations as outlined in Appendix 1. In setting the fee, we have assumed:
 - The overall level of risk in relation to the audit of the financial statements is not significantly different from that identified for 2010-11;
 - You will inform us of any significant developments impacting on our audit;
 - Internal audit continues to meet the appropriate professional standards;
 - Internal audit undertakes appropriate work on all areas as agreed with KPMG;
 - The fee does not include a provision for any additional work we may incur reviewing your accounting conclusions on complex and unusual matters – the fees for these services will be agreed with you in advance of commencing such incremental work;
 - The fee does not include a provision for any additional control review or data validation audit work that may arise due to changes in your structure and processes as a result of Project Horizon. The additional fee, if any, will also be agreed with you in advance of such additional procedures;
 - You will identify and implement within your 2011-12 financial statements any changes required under the CIPFA IFRS-based Code of Practice on Local Authority Accounting;
 - Your financial statements will be made available for audit in line with the timetable we agreed with you;
 - Good quality working papers and records will be provided to support the financial statements by the date we agree with you;
 - 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 or for special investigations such as those arising from disclosures under the Public Interest Disclosure Act 1998.
- Meeting these expectations will help ensure the delivery of our audit within the agreed audit fee.

Changes to the audit plan

- Changes to this plan and the audit fee may be necessary if:
 - New significant 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 financial reporting requirements.
- If changes to this plan and the audit fee are required, we will discuss and agree these initially with the Head of Group Financial Accounting and Chief Finance Officer.

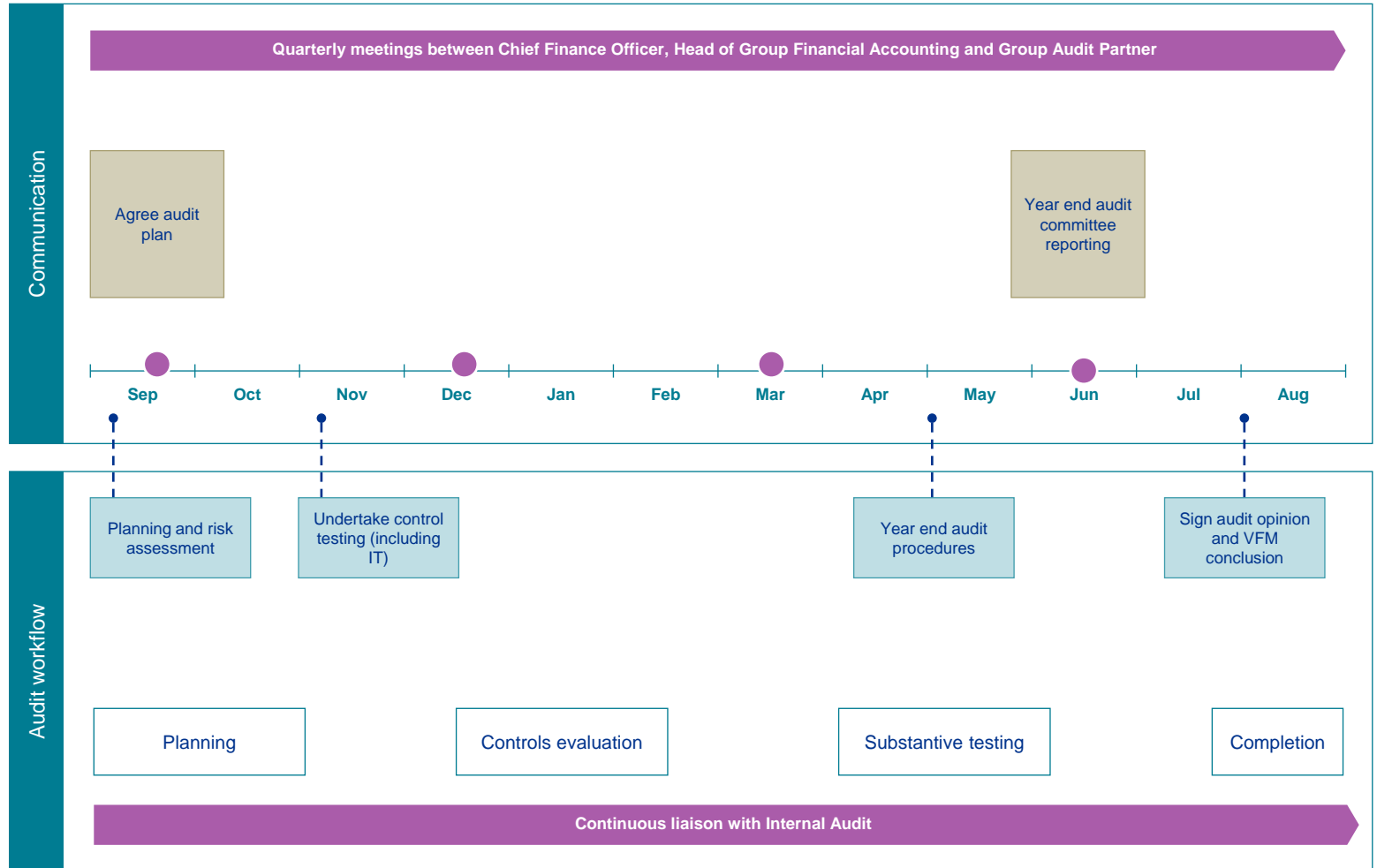
Audit timeline and deliverables

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

Deliverable	Purpose	Timing
Planning		
Audit plan	<ul style="list-style-type: none"> ■ Outline audit approach. ■ Identify areas of audit focus and planned procedures. ■ Confirm plan with Audit Committee. 	September 2011
Final Audit		
Report to those charged with governance (ISA 260)	<ul style="list-style-type: none"> ■ 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 2012
Opinion on financial statements	<ul style="list-style-type: none"> ■ Financial Statements opinion. 	July 2012
Value for Money		
Opinion on economy, efficiency and effectiveness	<ul style="list-style-type: none"> ■ Value for Money conclusion. 	July 2012
Annual Audit Letter		
AAL	<ul style="list-style-type: none"> ■ High level summary of work carried out. 	September 2012

Audit timeline and deliverables (cont.)

We will be in continuous dialogue with you throughout the audit.



Key: ● Audit Committee meetings.

Appendices

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.
- Wayne Southwood and Robert Brent will attend all Audit 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

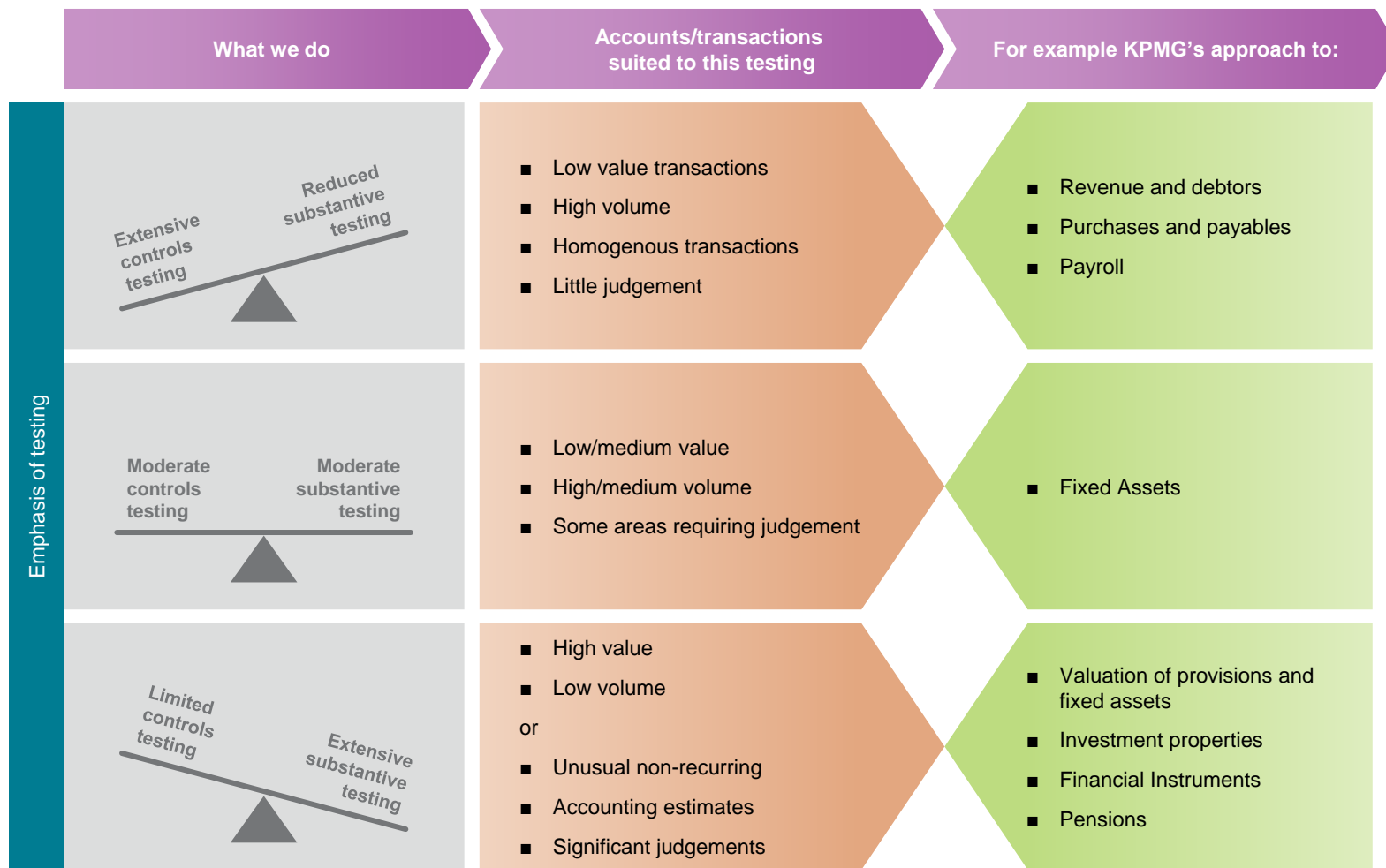
- Discuss and agree our draft Annual Audit Letter in good time for the Audit Committee.
- Ensure that all action plans are agreed and followed up in due course.

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.



Note: Assuming controls are found to operate as designed.

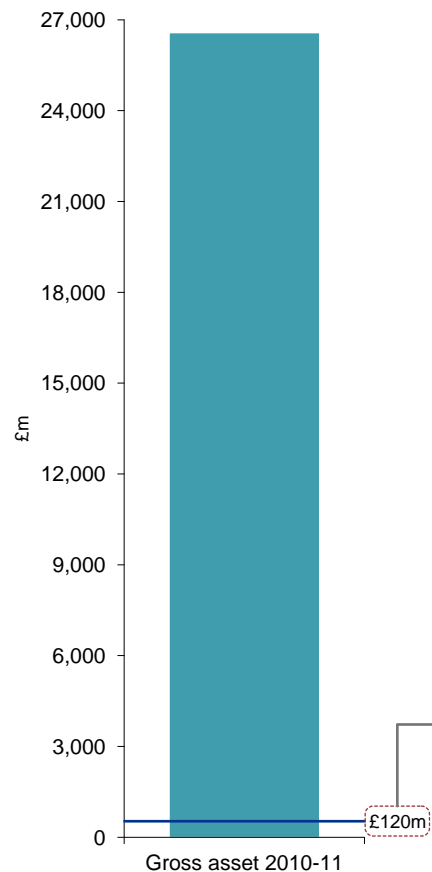
This appendix summarises the auditor's responsibilities regarding independence and objectivity.

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.

Our audit work is planned to detect errors that are material to the accounts as a whole.

Gross assets



Note: Materiality may be updated on receipt on the draft financial statements and will be less for individual entities.

Source: 2010-11 financial statements.

Determining materiality

We consider quantitative and qualitative factors in setting materiality and in designing our audit procedures.

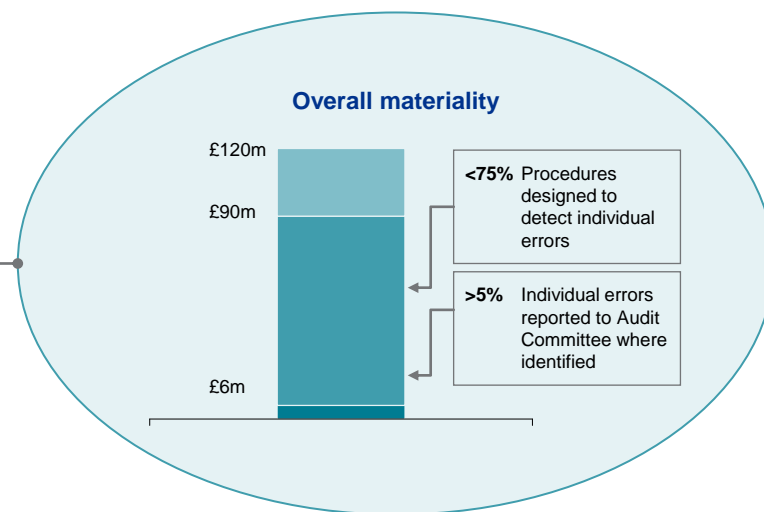
Materiality has been set at £120 million for all balances which is 0.38% of gross assets.

We design our procedures to detect errors at a lower level of precision, i.e. £90 million; we have some flexibility to adjust this level downwards.

Reporting to Audit Committee

To comply with auditing standards, the following three types of audit differences will be presented to the Audit Committee:

- summary of adjusted audit differences.
- summary of unadjusted audit differences.
- summary of disclosure differences (adjusted and unadjusted).



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 2011-12 will include: 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

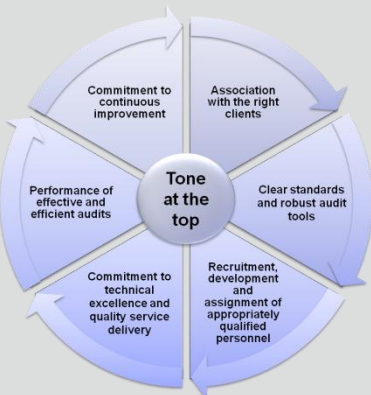
- It is the responsibility of management to establish a control environment and maintain policies and procedures to assist in achieving the objective of ensuring, as far as possible, the orderly and efficient conduct of the entity's business.
- It is the responsibility of those charged with governance 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 2011. 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 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
<p>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.</p>	<ul style="list-style-type: none"> 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.
<p>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.</p>	<ul style="list-style-type: none"> 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.
<p>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.</p>	<ul style="list-style-type: none"> 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.
<p>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.</p>	<ul style="list-style-type: none"> 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 11.
<p>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.</p>	<ul style="list-style-type: none"> 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.
<p>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.</p>	<ul style="list-style-type: none"> Our report to those charged with governance summarises our audit findings and sets out our response to your key risks.
<p>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.</p>	<ul style="list-style-type: none"> 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.



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