

**TRANSPORT FOR LONDON**

**AUDIT COMMITTEE**

**SUBJECT: ANNUAL AUDIT AND INSPECTION LETTER**

**MEETING DATE: 12 MARCH 2008**

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**1 Purpose and decision required**

1.1 This report provides an overall summary of the Audit Commission's assessment of the organisation, drawing on audit, inspection and performance assessment work.

**2 Background**

2.1 This report was originally submitted to the meeting of the Audit Committee on 23 January 2008 but due to its late submission, was deferred.

**3 Recommendation**

3.1 The Committee is asked to NOTE the report.

Annual Audit and Inspection Letter

February 2008



# Annual Audit and Inspection Letter

Transport for London

External audit is an essential element in the process of accountability for public money and makes an important contribution to the stewardship of public resources and the corporate governance of public services.

Audit in the public sector is underpinned by three fundamental principles:

- auditors are appointed independently from the bodies being audited;
- the scope of auditors' work is extended to cover not only the audit of financial statements but also value for money and the conduct of public business; and
- auditors may report aspects of their work widely to the public and other key stakeholders.

The duties and powers of auditors appointed by the Audit Commission are set out in the Audit Commission Act 1998 and the Local Government Act 1999 and the Commission's statutory Code of Audit Practice. Under the Code of Audit Practice, appointed auditors are also required to comply with the current professional standards issued by the independent Auditing Practices Board.

Appointed auditors act quite separately from the Commission and in meeting their statutory responsibilities are required to exercise their professional judgement independently of both the Commission and the audited body.

### **Status of our reports**

This report provides an overall summary of the Audit Commission's assessment of the Council, drawing on audit, inspection and performance assessment work and is prepared by your Relationship Manager.

In this report, the Commission summarises findings and conclusions from the statutory audit, which have previously been reported to you by your appointed auditor. Appointed auditors act separately from the Commission and, in meeting their statutory responsibilities, are required to exercise their professional judgement independently of the Commission (and the audited body). The findings and conclusions therefore remain those of the appointed auditor and should be considered within the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission.

Reports prepared by appointed auditors are:

- prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission; and
- addressed to members or officers and prepared for the sole use of the audited body; no responsibility is taken by auditors to any member or officer in their individual capacity, or to any third party.

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For further information on the work of the Commission please contact:

Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ

Tel: 020 7828 1212 Fax: 020 7976 6187 Textphone (minicom): 020 7630 0421

[www.audit-commission.gov.uk](http://www.audit-commission.gov.uk)

# Contents

<b>Summary</b>	<b>4</b>
<b>Purpose, responsibilities and scope</b>	<b>5</b>
<b>Accounts</b>	<b>6</b>
<b>Use of resources</b>	<b>8</b>
Initial performance assessment follow-up	8
Use of Resources Assessment	11
<b>Closing remarks</b>	<b>13</b>

## Summary

- 1 The key messages and recommendations from our audit and inspection work are set out in table 1 below.

**Table 1 Key outcomes and recommended actions**

Area	Key messages	Recommended action
<b>Accounts</b>		
Opinion	KPMG issued an unqualified audit opinion on 9 July 2007.	None.
<b>Use of resources</b>		
Initial performance assessment follow-up - direction of travel	TfL has made good progress on improving outcomes in priority areas during the year.	Continue to maintain this momentum.
Initial performance assessment follow-up - use of resources	TfL has maintained an overall score of four in respect of its use of resources which means it is performing strongly – well above minimum requirements.	Continue to review management arrangements over economy, efficiency and effectiveness.
Value for money conclusion	KPMG issued an unqualified value for money conclusion on 9 July 2007.	None.
Best value performance plan	KPMG issued an unqualified auditor's report on 12 November 2007.	None.

## Purpose, responsibilities and scope

- 2 This letter provides an overall summary of the Audit Commission's assessment of TfL, based on audit and inspection work performed in relation to the accounting period ended 31 March 2007, and from a wider analysis of TfL's performance and its improvement over the last year.
- 3 The report is addressed to TfL, in particular it has been written for Board members, but is available as a public document for stakeholders, including members of the community served by TfL. The letter will be published on the Audit Commission website at [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk).
- 4 KPMG are TfL's appointed auditors. They are responsible for planning and carrying out an audit that meets the requirements of the Audit Commission's Code of Audit Practice (the Code). Under the Code, KPMG are required to review and report on:
  - TfL's accounts; and
  - whether TfL has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion).
- 5 The letter commences with a summary of the outcome of KPMG's audit of the accounts. It then considers TfL's use of resources, including the annual refresh of the 'initial performance assessment' (IPA), undertaken in 2004, and the value for money conclusion, including the outcomes from specific reviews carried out in the year.
- 6 We have listed the reports issued to TfL since our last audit and inspection letter at the end of this letter for information.

## Accounts

- 7 The overall outcomes of KPMG's audit of TfL's accounts for the year ended 31 March 2007 are:
  - an unqualified opinion, issued on 9 July 2007; and
  - a conclusion on TfL's arrangements to secure economy, efficiency and effectiveness in its use of resource was issued to say that KPMG were satisfied that proper arrangements were in place for the year ended 31 March 2007.
- 8 Some key issues to work on to enhance arrangements include:
  - Continue to consider the risk of the PPP contracts, particularly in light of the recent administration of Metronet, incorporating any lessons learned. TfL has demonstrated that it was prepared for the impact of Metronet going into administration and how this impacted on TfL's financial management arrangements.
  - Review the arrangements for managing risks, specifically in those areas where are dependent on relationships with a range of other organisations which increases TfL's portfolio of risks.
  - Consider the implementation of a comprehensive programme of risk management training for Board Members and Key Risk Champions to ensure they are adequately skilled in this area.
  - Continue to monitor the arrangements in respect of Board Members and senior officers, particularly those officers and employees in commercially sensitive roles, to ensure they are following best practice in their code of conduct.
  - Continue to develop arrangements over data quality, demonstrating a track record of using high quality information consistently across the whole organisation, on costs and quality to actively manage performance, improve value for money and inform decisions of where to invest resources.
- 9 There was an improvement in the accounts production and audit timetable for the year ended 31 March 2007, and this has impacted on TfL's Financial Reporting score within Use of Resources which improved from a level three to a level four. The financial statements were produced well within the statutory deadline of 30 June and accounts packs and working papers to support them were delivered to KPMG in accordance with the agreed timetable. A good draft of the Annual Report was available for review alongside the draft accounts. Few changes were required which resulted in efficiencies to the accounts production and audit processes.

- 10 During 2006/07, considerable changes were made to the form and content of TfL's accounts in accordance with the requirements under the Local Authority Statement of Recommended Practice (SORP) for 2006. A review of the process for adopting these changes and whether TfL's accounts were in compliance with the 2006 SORP was performed. KPMG found no issues which were required to be reported to those charged with governance. TfL and KPMG are already in discussion regarding the required changes as a result of the 2007 SORP, particularly over fixed asset reserves.
- 11 The assumptions over the Public Sector Section of the TfL Pension Fund which at 31 March 2007 accounted for most of the pension liabilities were reviewed. Overall, these were considered to be appropriate for the purposes of FRS17 and in line with market practice.
- 12 A review of the key financial IT systems was performed by KPMG as part of the accounts audit to ensure that robust controls are in place over key financial reporting systems during the year. This work identified certain weaknesses, although a number of mitigating controls were identified that compensated for those weaknesses.

## Use of resources

- 13 The results of the IPA are followed up via two assessment processes, based on the 2007 local government approach, but tailored individually to the context of TfL:
  - a non-scored direction of travel assessment; and
  - a scored use of resources assessment.
- 14 KPMG are also required to issue a conclusion on whether they are satisfied that TfL has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

## Initial performance assessment follow-up

### Direction of travel

- 15 In November 2004 TfL was assessed as an 'excellent' authority following the IPA undertaken by the Audit Commission. This Direction of Travel assessment builds on our previous work.
- 16 TfL continues to make good progress, in particular against the targets in the Mayor's Transport Strategy. The Improvement Plan that was in place following the IPA has now been substantially completed. This includes key areas that were outstanding in December 2006, such as communicating with stakeholders and putting in place revised human resource and equalities policies and procedures.
- 17 In practice, new actions have been added to the Plan in order to implement key initiatives, such as achieving 'One TfL', reducing travel demand and service quality improvements. Continuing with the Plan indicates a strong approach to ensuring continuous improvement. One of the new key actions is the development of overall objectives to reflect the long term vision for the transport network set in the T2025 document.
- 18 Headline achievements over the last year include increasing the number of passengers on the TfL network by around 80 million to nearly 3 billion, maintaining high levels of public satisfaction across the modes of transport and reducing the number of those killed and seriously injured on London's roads (50 per cent by 2010 against the baseline in 1994/98). Despite Metronet going into administration, TfL was able to keep services running effectively.
- 19 Through effective partnership working with British Transport Police and the Metropolitan Police, security on all modes of transport has been improved. TfL has also won Capital's Transport Award for the journey planner on the internet. Another notable achievement was the refurbishment of Wembley Park station ahead of the new Wembley stadium being opened.

- 20 TfL continues to contribute to the Mayor's priority of making London a greener city. For example, the Central London Congestion Zone has been extended westwards. Initial monitoring of the western extension to the Zone shows a reduction of 13 per cent in traffic. This has a direct impact on reducing the level of carbon emissions in central London. The first hybrid bus entered service in early 2007. As the fleet is expanded to include more of these hybrid buses there is a reduction in both emissions and noise.
- 21 During 2006/07 TfL has delivered £193 million of efficiency savings against a target of £170 million. Including the cumulative savings from previous years, TfL has delivered efficiency savings of £576 million against its target of £1 billion by 2010. It is therefore on course for achieving this ambitious target.

### **Use of resources judgements**

- 22 The use of resources judgements assess how well authorities manage and use their financial resources. The assessment focuses on the importance of having sound and strategic financial management to ensure that resources are available to support priorities and improve services. KPMG are required to form judgements for each of the five themes that comprise the overall use of resources assessment:
- financial reporting (including the preparation of TfL's accounts and the way these are presented to the public);
  - financial management (including how financial management is integrated with strategy to support TfL's priorities);
  - financial standing (including the strength of TfL's financial position);
  - internal control (including how effectively TfL maintains proper stewardship and control of its finances); and
  - value for money (including an assessment of how well TfL balances the costs and quality of services).

- 23 Each theme was scored on the following basis:

**Table 2 Description of the scores reached**

Score/level	Description
1	Below minimum requirements – inadequate performance.
2	Only at minimum requirements – adequate performance.
3	Consistently above minimum requirements – performing well.
4	Well above minimum requirements – performing strongly.

Source: Audit Commission

- 24 The 2007 assessment criteria used to form our judgements were more demanding than the previous year. Against that background, TfL has continued to maintain its score of four and is performing strongly. This is the highest category.

**Table 3 Use of resources scores**

Area	Score 2007	Score 2006
Financial reporting	4 out of 4	3 out of 4
Financial management	4 out of 4	4 out of 4
Financial standing	4 out of 4	4 out of 4
Internal control	3 out of 4	3 out of 4
Value for money	4 out of 4	3 out of 4
<b>Overall</b>	<b>4</b>	<b>4</b>

Source: Audit Commission

## Use of Resources Assessment

- 25 Some key issues to work on to enhance arrangements include:
- Continue to consider and proactively manage the risks relating to the PPP contracts, particularly in light of the recent Metronet financial issues and Administration process, incorporating any lessons learned. During the year under review TfL demonstrated that it was prepared for the impact of Metronet entering the Administration process and the short term financial management arrangements as well as medium to long term plans were adjusted to manage the financial issues arising.
  - Review the arrangements for managing risks, specifically in those areas which are dependent on relationships with a range of other organisations which increases the group-wide risk profile.
  - Consider the implementation of a comprehensive programme of risk management training for Board Members and Key Risk Champions to ensure they are adequately skilled in this area.
  - Continue to monitor the arrangements in respect of Board Members and senior officers, particularly those officers and employees in commercially sensitive roles, to ensure they are following best practice in their code of conduct.
  - Continue to develop the arrangements over data quality, demonstrating a track record of using high quality information consistently across the whole organisation, on costs and quality to actively manage performance, improve value for money and inform decisions on where to invest resources.
- 26 KPMG concluded that TfL, having regard to the criteria for local authorities specified by the Audit Commission, in all significant respects made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2007. Their conclusion drew on a range of reviews including the work around Use of Resources, a review of the management arrangements over Data Quality and a review of the management arrangements for the Efficiency Programme.
- 27 KPMG were asked by the London Assembly on 15 June 2007 to investigate the economy, efficiency and effectiveness of payments made by TfL to the former Transport Commissioner since 1 February 2006. KPMG responded to the London Assembly on this matter on 13 November 2007 and reported to the Audit Committee on 21 November 2007.

### Counter-fraud arrangements

- 28 TfL continues to participate in and respond appropriately to the National Fraud Initiative, which is the Audit Commission's data matching exercise, designed to detect fraud perpetrated on public bodies.

### **Best value performance plan**

- 29 KPMG issued their report on the 2007/08 best value performance plan on 12 November 2007. There were no matters to draw to the Board's attention.

### **Financial position**

- 30 TfL's financial standing was assessed as part of the audit and the 2006/07 Use of Resources review where the score has been maintained at a level four. To continue with this performance, TfL should ensure that spending is managed within the resources available, that any potential overspends are quickly identified and mitigating actions implemented with a zero net impact on the overall financial position.

## Closing remarks

- 31 This letter has been discussed and agreed with Stephen Critchley. A copy of the letter will be presented at the Audit Committee meeting on 23 January 2008.
- 32 Further detailed findings, conclusions and recommendations on the areas covered by audit and inspection work are included in the reports issued to TfL during the year, set out in the table below:

**Table 4      Reports issued**

<b>Report</b>	<b>Date of issue</b>
Audit and inspection plan	March 2006
Report to those charged with governance	11 June 2007 / updated 5 November 2007
Opinion on financial statements	9 July 2007
Value for money conclusion	9 July 2007
Whole of government accounts submission	28 September 2007
Auditor's report on the best value performance plan 2007/08	12 November 2007
Use of resources auditor judgements	January 2008
Annual audit and inspection letter	March 2008

### **Audit fee update**

- 33 The fee proposals were reported as part of the 2006/07 Audit Plan. The table overleaf confirms that the estimated outturn fee will be contained within that set out in the audit plan and approved by the Audit Committee.

**Table 5 Fee update**

	<b>Plan 2006/07</b>	<b>Actual 2006/07</b>
Financial Statements and Statement on Internal Control	290,500*	290,500*
Use of resources	102,000	102,000
<b>Total audit fee</b>	<b>392,500</b>	<b>392,500</b>
Inspection	21,500	21,500
<b>Total audit and inspection fee</b>	<b>414,000</b>	<b>414,000</b>
Grant claim certification	15,000	7,055

\* - includes £4,500 for WGA certification and £14,000 additional IT audit fee for 2006/07

- 34 Finally, we would like to take this opportunity to thank TfL and its officers for the assistance and cooperation received during the course of our work this year.

Ken Davis  
 Relationship Manager  
 February 2008