

TRANSPORT FOR LONDON

AUDIT COMMITTEE

SUBJECT: INTERNAL AUDIT ANNUAL REPORT 2010/11

DATE: 15 JUNE 2011

1 PURPOSE AND DECISION REQUIRED

- 1.1 The purpose of this report is to summarise Internal Audit activity for the year ended 31 March 2011, to account for the use of resources and provide an opinion on the internal controls as required by the CIPFA Code of Practice for Internal Audit in Local Government. The Committee is asked to note the report.

2 AUDIT OPINION

- 2.1 Based on the work the Department has completed during the course of the year, which is set out in more detail below, and taking into account other sources of assurance including:
- (a) reviews carried out as part of the Corporate Gateway Approval Process (including the work of IIPAG);
 - (b) the work of other management assurance teams;
 - (c) the outputs from the (aborted) Use of Resources assessment by the external auditors;
 - (d) a review of the Control Risk Self Assurance exercises within TfL; and
 - (e) a review of the Statements of Control completed by London Underground,
- we have concluded that TfL's control environment is adequate for its business needs and operates in an effective manner.
- 2.2 There have been no matters arising from any of the work we have completed that require to be brought to the attention of the Audit Committee.
- 2.3 There have been no restrictions imposed on the scope of the internal audit function.

2.4 In addition, using assurance gained from our audit work on governance matters, we can conclude that TfL's code of governance, including internal control, is adequate and effective.

3 WORK DONE

Introduction

3.1 Internal Audit work falls into two main areas namely audit assurance as set out in the Audit Plan, and Fraud Awareness, Prevention, Detection and Investigation. In addition, we provide advice on controls and processes both via reviews and by attendance at working groups. The sections below explain the work that has been done in these areas in the past year.

Audit assurance

3.2 In any year, our Audit Plan can change significantly as projects and procurements are cancelled or deferred and new or changing risks take priority. For this reason, we use a "rolling" plan which means we confirm our audit schedule on a quarterly basis, although we have a view as to the work we aim to complete during the next twelve months.

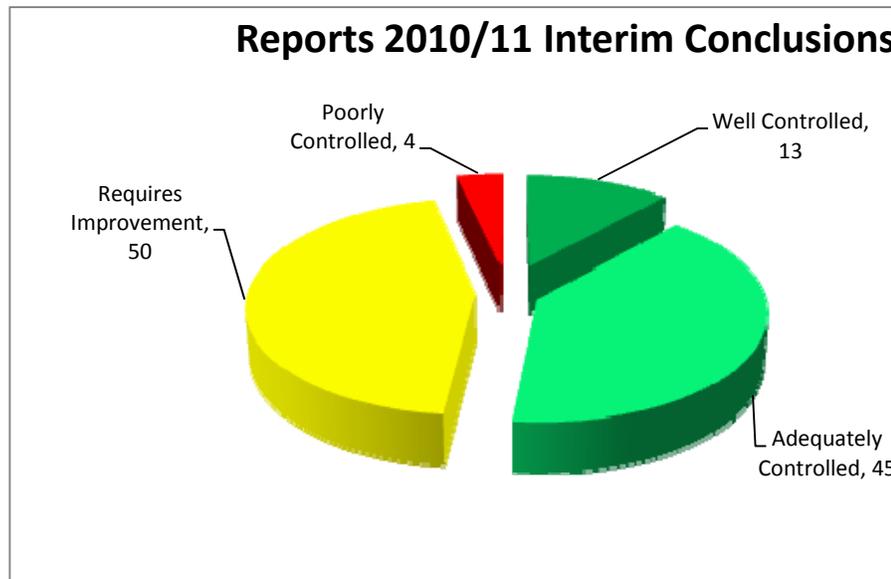
3.3 The proportion of time spent by business unit was:

	Actual 2010/11 (%)	Plan 2010/11 (%)
Group Wide	15.6	21.3
Finance	20.5	19.4
General Counsel	2.2	2.3
Group Mktg and Comms	3.5	3.7
Planning	0.1	0.8
Group HR	2.1	0.0
Surface Transport	16.0	16.4
London Underground	16.4	16.4
London Rail	8.4	6.8
Crossrail	11.5	10.0
Other (LTM/ Pension Fund)	3.7	2.9
	<u>100</u>	<u>100</u>

3.4 The actual time analysed above includes time spent on audits brought forward from the 2009/10 plan.

3.5 A number of audits in the 2010/11 Audit Plan were still in progress at 31 March. We also completed some audits carried forward from the 2009/10 Audit Plan during the

year. Our interim conclusions on work completed during the year are set out in the chart below.



- 3.6 Follow up audits and resulting final reports indicate that management action plans agreed as part of the audit process are being completed effectively and on a timely basis.

Other Work

- 3.7 In addition to the planned audit work above, we have also continued to be involved in Programme Boards and Steering Groups for major projects and other governance bodies, and have been represented on the following during the year:

- (a) Project Review Group Meeting;
- (b) LU ERP IP Programme Board;
- (c) LU Risk Management Meeting;
- (d) SAP Governance Risk and Compliance Governance Council;
- (e) YourIM Business Sponsor Group (BSG);
- (f) IM Security Peer Review Group;
- (g) Heads of Procurement Meeting;
- (h) PCI DSS Working Group;
- (i) Efficiencies Delivery Board;
- (j) Accommodation Strategy Programme Board;
- (k) International Financial Reporting Standards Project Steering Committee; and
- (l) Crossrail Integrated Assurance Group.

- 3.8 This involvement enables us to provide input on risk management and control matters at an early stage in major projects as well as allowing observation of project and other governance processes.

3.9 Our membership of the Crossrail Integrated Assurance Group commenced when we formed the group in 2009, with the purpose of providing a forum for various independent assurance providers to take an integrated approach to their activities in respect of Crossrail. Current membership of the group is TfL, CRL, DfT, ORR, MPA and NAO, and its success has been a factor in the acceptance by Major Projects Review Group of CRL's Assurance Plan.

Control Risk Self Assurance (CRSA)

3.10 CRSA is a process that enables management to assure themselves that key controls are operating across a whole process. It can reduce, but not eliminate, the need for internal audit. The CRSA returns are reviewed by Senior Audit Managers to ensure they are in line with audit findings during the year and to ensure the assurance gained is taken into account for the internal audit opinion. Any differences are discussed and resolved. LU also has a 'Statements of Internal Control' process which complements CRSA and is similarly subject to Internal Audit review.

Fraud Prevention, Detection and Investigation

3.11 During the year, a total of 52 fraud awareness sessions were delivered compared to a total of 32 in 2009/10. We also held the third TfL Fraud Awareness Week in December, which included publicity with posters and static stands at head office buildings including Crossrail and Tube Lines. During the week, we distributed leaflets to TfL staff advising them about protecting the organisation, and themselves.

3.12 We have continued to use data analytics not only in support of ongoing investigations but also in our preventative work to provide assurance that processes are not being abused for fraudulent reasons.

3.13 We have continued our work with Crossrail senior management on their counter fraud plan and strategy and the Fraud Risk Advisory Group has continued to meet. In addition, the information from the high level fraud risk workshops facilitated by the Fraud Team has been converted by Crossrail into a fraud risk register with actions and owners.

3.14 There were 45 new cases reported during 2010/11, added to the 32 cases brought forward from 2009/10. There were no significant trends identified from our investigations but we continue to investigate cases of identity theft and fraud or thefts of pensions.

3.15 Closed investigations of note were:

- (a) Alleged Fraud surrounding Annual Season Ticket. We were advised by the c2c Rail Onyx (Revenue) Team that a TfL employee had purchased an annual season ticket for £1,564 and the next day applied for a refund. During the refund process, the ticket clerk noticed that the employee, who was in LU uniform, had a ticket in his wallet that looked like a photocopied season ticket.

C2c Revenue Inspectors later stopped the TfL employee who produced a poor photocopy of his previously surrendered annual season ticket. The member of staff was arrested and subsequently pleaded guilty at Basildon Magistrates' Court to a charge under Section 6 of the Fraud Act, Possession of Articles Intended for Use in Fraud. He was sentenced to 300 hours Community Service, and ordered to pay £400 costs. The employee resigned from TfL on the same day that a LU disciplinary hearing was scheduled to take place.

- (b) Compensation Claims for Alleged Street Accidents. TfL insurers received two suspicious claims for compensation against TfL from a Mr Nathan Williams. The claims were referred to the Fraud Team for investigation. A joint TfL/MPS investigation linked Mr Williams to a series of fraudulent insurance claims against a number of organisations. These claims could have led to losses to TfL of over £40k and losses to other parties of over £95k. Mr Williams subsequently pleaded guilty in court to eight charges of fraud and had three further frauds taken into consideration. He was sentenced to 15 months in prison. TfL requested costs but Mr Williams has no means to pay and therefore this was not granted. The staff involved in this investigation have been recommended for an MPS Commander's Commendation for their work.
- (c) Stolen Company Cheques. The Fraud Team received information from National Express advising of the widespread use of stolen company cheques to purchase rail tickets. We asked for this information to be circulated to LU and were subsequently made aware of two stolen company cheques that had been used to purchase quarterly travel cards for the TfL network. Further enquiries revealed 22 further losses, the first occurring in January 2010, resulting in a total loss to TfL of over £14k.

In July, at Neasden LU Station, a ticket office clerk recognised the handwriting on a company cheque being used to buy a travel card as similar to the sample provided in the circulated information. This led to the arrest of a man by the BTP who has since been connected to 60 other cheque fraud incidents, against a variety of businesses.

- (d) Suspected Procurement Irregularity. Investigations found that a member of staff had ordered stationery supplies worth approximately £10k, which were then stolen. The employee was arrested and charged with five counts of theft. A disciplinary hearing was to be convened but the employee failed to turn up for the hearing and subsequently resigned. At court in October, the now former employee pleaded guilty to four specimen charges of theft of TfL property over a six month period between June and December 2009. She was subsequently sentenced to six months imprisonment suspended for 18 months, given a 120 hour Community Service Order and ordered to pay £225 court costs. The Judge wished to award TfL compensation of £9,438 but the former employee claimed to have no assets so the Judge asked whether this compensation could be taken from the former employee's TfL pension contributions. Following consultation with the TfL Pension Fund, this was

agreed and the Judge ordered the former employee to pay full compensation of £9,438 within 28 days from her pension contributions.

3.16 The disposal of cases throughout the past year (previous year's totals in brackets) is as follows:

	Investigations	
In Progress at 1 April 2010		32 (39)
New since 1 April 2010		45 (71)
Closed since 1 April 2010	No Crime/ Offence established	35 (48)
	Disciplinary Action Taken	7 (11)
	Police/ Judicial Action Taken	21 (19)
	Sub Total	64 (78)
In Progress at 31 March 2011		13 (32)

3.17 The 45 new investigations consist of 26 (36) fraud cases, 14 (26) reports of theft and five (nine) 'other' types of cases.

3.18 Reports were received from the following sources:

Source	2010/11	2009/10
Internal Audit	0	2
Internal Control	4	13
Staff Member	23	26
Member of Public	10	9
Law Enforcement Agency	3	5
Anonymous	2	3
National Fraud Initiative	3	13
Totals	45	71

4 INTERNAL AUDIT STRATEGIC REVIEW

4.1 A Strategic Review of Internal Audit, led by the Cost Reduction Team, commenced in July 2010 and a report setting out the recommendations from the review was shared with the Audit Committee at its December meeting and issued in final form in January 2011. The Strategic Review was carried out in parallel with, and its recommendations were aligned with, the Project Horizon Assurance work stream.

4.2 The key findings from the Strategic Review were as follows:

- (a) Remove the actual or perceived duplication of effort with regard to project assurance by recognising PMOs and IIPAG as the primary project assurance providers and reducing the volume of Internal Audit work in this area;

- (b) Use modal risk registers rather than the strategic risk register to target audit work;
- (c) Develop an integrated assurance plan linked to the TfL Business Plan;
- (d) Refocus audit report formats to ensure these fully meet the needs of both local and senior management, and the Audit Committee;
- (e) Review and refocus audit methodologies to ensure greater consideration of value for money in audits and to build on the department's role in spreading best practice; and
- (f) Reduce overall staff costs by around 25 per cent.

4.3 Our Annual Audit Plan for 2011/12 already reflects a number of these recommendations. We will be reviewing our reporting formats and ways of working over the next few months to ensure that these fully meet the needs of TfL going forward and to address the recommendations from the Strategic Review.

4.4 In addition, a project is being initiated to develop an integrated assurance plan for TfL. An Assurance Delivery Group will be formed to co-ordinate delivery of the plan, which will be chaired by the General Counsel and include membership from the main assurance providers and the business. A report will be provided to the Audit Committee in September on the approach being taken to development of the integrated assurance plan.

4.5 In order to deliver the required reduction in staff costs an organisational change process was initiated in February 2011 and completed in May 2011 with the new departmental structure going live on 9 May 2011. This has delivered a reduction in budgeted headcount from 57 to 42. However, we had been holding five vacant posts pending the outcome of the Strategic Review, so in total a further ten individuals have left the department as a result of the Organisational Change Policy (OCP), six of whom agreed voluntary severance. The most significant area of change is in respect of the previously separate teams for Projects and Contracts, which have merged into a single team covering both these areas, but there are smaller staff reductions across most areas.

5 RESOURCES

Staff

5.1 The post of Director of Internal Audit was filled throughout the year on an interim basis by the Senior Audit Manager – Business Processes. The consequential Senior Audit Manager vacancy has also continued to be filled on an interim basis. Recruitment of a permanent Director was put on hold pending completion of the Strategic Review and subsequent OCP, but this is now expected to be restarted shortly.

- 5.2 There were few staff changes during the year, with just two Internal Auditors and one Fraud Investigator leaving the department. These vacant posts were not filled pending the outcome of the Strategic Review. As noted in 4.5 above, a further ten members of staff have left the department since the year end as a result of the OCP.

Staff training and development

- 5.3 Our training strategy sets out the standards we require for all staff both to maintain their existing professional qualifications and to ensure they receive sufficient continuous training in internal audit and fraud investigation (as appropriate) to keep them up to date with best practice. All of our joiners into audit positions who do not have previous audit experience must complete the IIA's Certificate of Internal Audit during their first year in the department, and several members of the department have now achieved this qualification. In addition, three members of the department are now studying for the IIA's Diploma, which is the next level of professional internal audit qualification.
- 5.4 We continually monitor training to ensure all staff are achieving the requisite standard and also to monitor costs. Our training budget has been reduced over the last couple of years, but through judicious selection of courses, including making use of free or discounted courses, we have again underspent the training budget. We are, therefore, comfortable that the training provision is sufficient for us to maintain our high standard of professionalism.

Co-sourcing

- 5.5 We continued to use Ernst & Young (EY) to supplement our resources during the year under our co-sourcing contact. However, our use of EY staff was again reduced, as a result of our enhanced capacity to audit SAP using in-house resource.
- 5.6 The co-sourcing contract expired in April 2011 and has not been renewed. Instead a GLA Group wide contract for Specialist Internal Audit Services is in the process of being tendered. We will be able to use that contract to help us resource our audit work if required, but in practice we expect that use of the contract will be infrequent.

6 INTERNAL AUDIT PROCESSES

- 6.1 During the year, we carried out an internal Quality Assurance review of our audit processes to ensure that our audits are being carried out in accordance with the requirements of our audit manual and with best practice. The review identified a small number of areas where our documentation of audits could be improved, and these have been communicated to staff. This followed a similar exercise completed the previous year, and we were pleased to note that there had been significant improvements with regard to the points noted in the previous year's review.
- 6.2 We have continued to improve the efficiency of our IM audit approach by increasing our in-house SAP audit capability and reducing reliance on our co-sourcing partner. In

addition to specialist training for IM auditors, we organised an internal SAP auditing training course during the year that was attended by all auditors.

- 6.3 We continue to explore opportunities to enhance our internal audit capabilities further and increase the effectiveness of our approach by introducing the concept of continuous auditing. We are currently piloting the use of continuous auditing techniques through tests focusing on changes to supplier bank details and the use of powerful SAP profiles within TfL.

7 BENCHMARKING AND NETWORKING

- 7.1 Throughout the year we have met regularly with representatives of other assurance providers, including the LU SQE audit team, and the Head of IPMO to discuss upcoming work and ensure that any potential areas of overlap are properly managed. We have also commenced regular meetings with the Tube Lines audit team.
- 7.2 To ensure that TfL's Internal Audit department remains up to date and understands best practice, it is important that we meet and work with other Internal Auditors and Fraud Investigators as well as attending and speaking at conferences relevant to our professional and business needs. The department has memberships of the Chartered Institute of Internal Auditors, CIPFA and the Association of Certified Fraud Examiners among others, which means we receive copies of publications, newsletters and updates from these bodies that assist in ensuring that we are up to date.
- 7.3 Members of the team also belong to a range of external bodies, including the CIPFA Procurement and Contract Audit Forum; the London Audit Group; the Working Group of the IIA Technical Committee; the Association for Project Management (APM) Specific Interest Group on Project & Programme Assurance; the APM Audit and Performance Review Committee; the Institute of Risk Management, the Institute of Occupational Safety and Health; the Security Institute; the London Fraud Forum; the National Federation of Fraud Forums; the National Fraud Authority Public Sector Procurement Fraud Working Group; and the Fraud Advisory Panel.
- 7.4 We have been leading work, through the Association for Project Management, in liaison with a number of organisations including the Government Efficiency and Reform Group, to develop general guidance on how organisations can integrate their assurance activities across their investment programmes.
- 7.5 We have written a professional guidance paper entitled 'An Introduction to Projects and Project Auditing' that has been adopted by the Chartered Institute of Internal Auditors as its national guidance on the topic.

8 CUSTOMER FEEDBACK

- 8.1 At the end of every audit, we send out a customer feedback form to the principal auditee(s) requesting their views on the audit process and the report. The form is

questionnaire based so it can be completed easily and quickly. A copy of the questionnaire is included in Appendix 1.

- 8.2 Our return rate for feedback forms has increased to 69 per cent from 60 per cent in 2009/10, the highest return rate that we have achieved. The majority of respondents are satisfied with the way we carry out our work with the commonest criticisms being around understanding the scope of the audit and the length of time it can take to complete the fieldwork and issue the draft report for discussion. The summary of scores for 2010/11 and prior years is set out in the table below.

	Strongly Agree %	Agree %	Disagree %	Strongly Disagree %
2006/07	38	54	7	1
2007/08	35	56	7	2
2008/09	32	56	10	2
2009/10	40	51	8	1
2010/11	37	51	11	1

- 8.3 A more detailed analysis is shown in Appendix 1.
- 8.4 The majority of respondents are satisfied with the way we carry out our work, and we received only five 'Strongly disagreed' scores across 78 forms returned. However, the proportion of 'Disagreed' scores has increased somewhat by comparison with 2009/10. The commonest criticism relates to the length of time it can take to complete the fieldwork and issue the draft report, and we have highlighted this as a key area for performance improvement during 2011/12. All feedback that is less than satisfactory is followed up by the Director of Internal Audit to ensure the concern is understood, discussed with the audit team and lessons learned where appropriate.

9 RECOMMENDATION

- 9.1 The Audit Committee is recommended to NOTE this report.

10 CONTACT

- 10.1 Contact: Clive Walker, Interim Director of Internal Audit
 Number: 020 7126 3022
 Email: CliveWalker@tfl.gov.uk

CFF sent (period 1 – 13): 113 2009/2010: 133

CFF returned (period 1 – 13): 78 2009/2010: 75

Customer Feedback Form – SUMMARY OF RESPONSES FOR 2010/11

Understanding our customers' needs and expectations and ensuring we are meeting them, is an important part of the continuous improvement we strive for in Internal Audit. We have recently worked with you on an audit project and would be grateful if you would take a few moments to give us feedback on our performance – after all, we have just given you feedback on yours!

Scale (please tick one):

1 = Strongly agree, 2 = Agree, 3 = Disagree, 4 = Strongly disagree

	Question	1	2	3	4	No mark given
1	Communication prior to the audit work was appropriate and I was aware of visit dates and objectives before the work started	36 (37)	38 (36)	3 (2)	1 (0)	0 (0)
2	Throughout the audit process I was kept informed of the work being done and issues arising	27 (24)	41 (40)	9 (11)	1 (0)	0 (0)
3	Internal audit staff demonstrated a good understanding of the business and associated risks (or took the time to develop such understanding during the audit process)	22 (20)	45 (49)	9 (4)	2 (2)	0 (0)
4	Internal audit staff demonstrated a pragmatic and commercial approach to developing solutions to issues identified during the audit	21 (21)	45 (42)	12 (7)	0 (0)	0 (0)
5	The audit report was issued in a timely fashion and was a fair summary of audit findings and management responses	27 (28)	35 (35)	15 (10)	1 (2)	0 (0)
6	Internal audit staff acted in a professional manner throughout the assignment	41 (49)	34 (25)	3 (0)	0 (1)	0 (0)

7. What did we do best?

'I was kept informed the whole time by the auditor of their findings so was able to implement some of the recommendations even before the final audit was submitted.'

'Communicated the objectives of the audit well prior to the audit commencing and there was good communication and exchange of information and feedback during the audit.'

'Produced a short well focussed report which tactfully identified an issue but did not make a meal out of small issues'.

'Conducted a useful audit which was both objective and productive for the end business unit'.

'Good communication between audit officer and project manager. Audit staff approached other members of the project team as and when required to gain a better understanding of the project working groups.'

'Initial engagement meeting was well structured and provided a clear context for the audit scope and process. The process became more constructive and pragmatic during the later stages of the process'.

8. What could we have done better?

'Understand the scope and understand the impact of going off scope and not listening to the people affected by it.'

'I would like to have had an opportunity to review a final draft audit report and commented on its content and accuracy before it was finalised.'

'It would have been interesting to have had a discussion on our Risk Schedule using the Audit to think about what we might do better.'

'More time was needed in terms of interview sessions. A better plan of meetings could be arranged so that all of the sessions could be covered more efficiently'.

'Provision of an advanced copy of the audit findings before it being widely distributed would have allowed time to rectify any misunderstandings.'

'I would have welcomed the opportunity to discuss concerns and issues earlier in the engagement process (especially given the nature of the concerns) and prior to the initial review meeting with sponsor.'