

TRANSPORT FOR LONDON

AUDIT COMMITTEE

SUBJECT: INTERNAL AUDIT ANNUAL REPORT 2007/08

MEETING DATE: 11 JUNE 2008

1 PURPOSE

1.1 The purpose of this paper is to summarise Internal Audit activity for the year ended 31 March 2008, 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.

2 AUDIT OPINION

2.1 We have concluded that TfL's control environment is adequate for its business needs and operates in an effective manner. based on the work we have completed during the course of the year, which is set out in more detail below, and taking into account other sources of assurance including:

- Independent Engineer reviews;
- the work of other management assurance teams;
- the result of the Use of Resources assessment by the external auditors;
- a review of the Control Risk Self Assurance exercises within TfL; and
- a review of the Statements of Control completed by London Underground.

2.2 There have been no matters arising from any of the work we have completed which 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 and the specific review carried out on the preparation of the Statement of Governance, 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: Business and Security audits as set out in the Audit Plan and Fraud Awareness, Prevention, Detection and

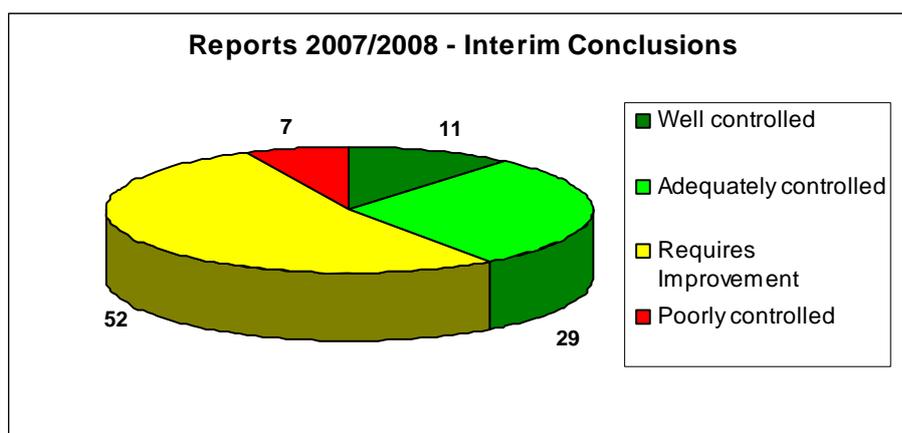
Investigation. In addition, we carry out work outside of the Audit Plan and are developing Control Risk Self Assurance processes. The sections below explain the work that has been done in these areas in the past year.

Business and Security Audits

- 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 have moved to 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 Our Audit Plan for 2007/08 envisaged 5,551 days plus contingency of 449 making a total of 6,000. In the event we added 407 days at management’s request compared to the 449 provided, but cancelled or deferred 1,416 days due to amended project and contract plans. We also significantly amended our original Information Management (IM) Audit Plan so we could focus more on supporting the Chief Information Officer, who joined at the end of February 2007, as he undertook a significant programme of work to reorganise and restructure the IM function.
- 3.4 In addition, 2007/08 has been a challenging year in respect of resources. Having recruited a significant number of auditors in 2004, following the transfer of London Underground to TfL, this year marked the three year point which is commonly when many auditors look to move to their next role. We also had a number of auditors promoted to managers’ positions and turnover was higher than expected.
- 3.5 This has impacted on the number of days we have been able to spend on audit work. This year we have not sought to identify replacements for deferred projects and contracts as we would normally. We have also looked harder at combining audits to cover scopes more efficiently. We have, however, kept our coverage of business units and risk under review to maintain the proportions agreed in the Audit Plan.
- 3.6 The proportion of time spent by business unit was:

	Actual 2007/08	Plan 2007/08
Group Wide	9.8%	25.5%
Group Services	13.2%	10%
Finance	18.3%	13.8%
Planning	2.5%	2.9%
General Counsel	4.7%	2.5%
Group Mktg & Comms	4.2%	2.3%
Surface Transport	22.6%	17.3%
London Underground	20.8%	22.2%
London Rail	3.9%	3.5%
	<u>100%</u>	<u>100%</u>

- 3.7 Variances are caused by the re-allocation of audits shown in the plan as 'group wide' but allocated to business units when specifically scoped. The proportions are also influenced by the impact of cancelled and deferred projects and contracts and by management requests for additional work. In the latter category we have done more additional audits in Surface Transport than in other units.
- 3.8 A number of audits in the 2007/08 Audit Plan were still in progress at March 31. We also completed some audits carried forward from the 2006/07 Audit Plan during the year. Our interim conclusions on work completed during the year were:



- 3.9 The 11 'well controlled' reports were spread across the business but four were in respect of security matters and three covered various aspects of ticket revenue.
- 3.10 The 'poorly controlled' reports arose across a number of risks and business units and do not indicate any common theme or trend.
- 3.11 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

- 3.12 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 have been represented on the following during the year:

- IM Steering Committee
- Project Review Group
- Corporate Investment Review Group
- East London Line Project Delivery Group
- PPM Capability Review Group
- LU Risk Management Meeting
- North London Rail (formerly Silverlink Metro) Steering Group
- PRP/SMRF Project Board

- Investigations and Prosecutions Review Steering Group
- Audit Activity within CPO meeting
- Salary Sacrifice Project Board
- Ethical Compliance Review Group
- Business Planning 2007 Workshop
- Palestra Assurance Group
- Project Delta Board Meeting
- Radar Steering Group Meeting
- Learning and Development Stakeholder Forum

3.13 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.

Control Risk Self Assurance (CRSA)

3.14 Control Risk Self Assurance 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 process continues to be managed by a dedicated resource within the Internal Audit team. The CRSA returns are reviewed by Senior Audit Managers to ensure they are in line with audit findings during the year. Any differences are discussed and resolved. The results of the CRSA process are used to focus audit efforts during the year on those areas where control improvements are identified as being needed. LU also has a 'statements of internal control' process which complements CRSA and is similarly subject to Internal Audit review.

3.15 The key processes developed in previous years for Financial Accounting, Payroll, Procurement, HRS and Station Security were each reviewed and completed by the relevant Finance Director or process owner in each mode.

3.16 This year the CRSA process has undergone a consolidation review to update CRSA processes that have been in place for the past 3 years. Primarily this included the Financial Accounting, Payroll and Procurement CRSA processes. Development work in IM has been moved to 2008-09 to align it with the appointment of an IM Risk professional. The HRS CRSA will also undergo a review during 2008-09 to ensure it is better streamlined to the changes that have been undertaken with HRS processes during 2007-08.

3.17 The TfL model for CRSA was entered for the Chartered Institute of Public Accountant's (CIPFA) Cliff Nicholson Award for innovation and excellence in Internal Audit for its innovative approach in implementing CRSA within the less traditional non financial areas of Station Security and HRS. This approach was mentioned and commended at the Awards ceremony held in April.

Fraud Awareness, Prevention, Detection and Investigation

- 3.18 We have doubled the number of fraud awareness presentations rolled out to TfL staff and have prioritised our roll out to the higher risk areas. The full roll out of the fraud awareness e-learning package will be introduced in early 2008/09.
- 3.19 We have also further developed our Forensic Data Analytical capability with the results of our detailed analytical work being used in a number of successful court cases. New analytical tools have been identified and are being procured.
- 3.20 There were 102 new cases reported during 2007/08, added to the 56 cases brought forward from 2006/07.
- 3.21 The investigations of note were:

Pension Investigations. We have continued to support the TfL Pension Fund (TfLPPF) with investigations into overpayments of pensions following the death of the pensioner. We have conducted 17 such investigations this year in addition to the 9 investigations brought forward from last year. The forward savings for the TfLPPF as a result of our investigations and other preventative work is estimated at £3.3m. In addition to investigating pension overpayments, we have also assisted the TfLPPF in tracking dependants who are eligible for pensions.

Falsification of Accounts. A LU member of staff was convicted of stealing approximately £37,000 through the falsification of Station weekly accounts at Victoria LU Ticket Office over an eight year period. He pleaded guilty to seven cases of false accounting and one of theft at the Crown Court and was sentenced to 16 months imprisonment. New measures have been put in place to prevent a similar fraud taking place.

Overtime Fraud. Following another investigation, an LU employee pleaded guilty to falsifying SAP approvals resulting in fraudulent overtime payments totalling over £33k. The employee was sentenced to 9 months imprisonment, suspended for 2 years, and given a supervision order for 2 years. TfL recovered all of the money stolen. This crime arose due to the sharing of passwords and we have conducted an exercise to gain assurance that this practice has ceased within the business.

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

	<i>Investigations</i>	
In Progress at 1 Apr 07		56 (96)
New Since 1 Apr 07		102 (110)
Closed since 1 Apr 07	No Crime/ Offence established	59 (61)
	Disciplinary Action Taken	15 (8)
	Police/ Judicial Action Taken	30 (81)
	Sub Total	104 (150)
In Progress at 31 Mar 08		54 (56)

3.23 The 102 new investigations consist of 31 (41) fraud cases, 21 (29) reports of theft and 50 (40) 'other' types of cases.

3.24 Reports were received from the following sources:

Source	Brought Forward	New 2007/08	Totals
Internal Audit	0	0	0
Management Control	32	31	63
Staff Member	6	4	10
Member of Public	1	6	7
Law Enforcement Agency	6	2	8
Anonymous	3	7	10
National Fraud Initiative	8	52	60
Totals	56	102	158

4 RESOURCES

Business and Security Audit

	Director	SAMs	Manager	Auditors	Secondee	Admin /Tech	Total
1/04/07	1	5	6	20	1	3	37
Joiners	-	1	1	5	1	2	10
Promotions	-	-	4	(4)	-	-	-
Leavers	-	(1)	(5)	(6)	(2)	(1)	(15)
31/03/08	1	5	7	15	-	4	32
Budget	1	5	8	19	-	5	38
Variance	-	-	(1)	(4)	-	(1)	(6)

- 4.1 The Head of Risk Management is included in the Senior Audit Manager numbers.
- 4.2 This has been a year of high staff turnover because a significant proportion of our staff had joined the department three to four years ago and so had reached the stage where it was natural for them to be considering their next career move.
- 4.3 It is pleasing that we have been able to fill four of the manager vacancies that arose during the year by internal promotions, although this has had a knock on effect on the number of internal audit vacancies that we have needed to fill.
- 4.4 In the course of the year the Strategic Security & Planning Manager position was discontinued, and we have also reduced the number of Security Auditors by one as a result of the introduction of a security control risk self assurance process for LU stations and a consequent decrease on the number of audits in that area. However, we have added an IM Audit Manager position to our headcount.
- 4.5 We had six vacant positions at the year end, including one Audit Manager – Projects, three internal auditors, one IM auditor and one business support role. With the exception of the business support role, all these vacancies have now been filled.
- 4.6 For 2008/09, the Metronet internal audit team will shortly be at full strength. Recruitment of a Senior Audit Manager for Crossrail is already underway and we will be reviewing resources towards the end of the year to support this role.

Fraud Prevention, Detection and Investigation

	SAM	Manager	Fraud Invest	Fraud Det/Prev	Admin	Total
1/04/07	2	1	6	3	2	14
Joiners	-	-	-	-	-	
Secondees	-	-	(1)	-	-	(1)
Leavers	(1)	-	(1)	(1)	-	(3)
31/03/08	1	1	4	2	2	10
Budget	1	1	4	3	2	11
Variance	-	-	-	(1)	-	(1)

- 4.7 The former Head of Fraud & Security retired early in the year and his deputy, the former Controller – F&S, took on a new role as Senior Audit and Investigations Manager – F&S, equivalent to the Senior Audit Manager roles in the Business Audit section.
- 4.8 The number of Fraud Investigators has reduced by two. One of these was a secondee who moved out of Internal Audit into a fraud prevention role within the business. The other was an investigator who had been engaged on a temporary basis specifically to carry out work on the first iteration of the National Fraud Initiative, who left us when that work came to an end.
- 4.9 There was one vacancy in this department at the year end for a Data Analyst.

Staff training and development

- 4.10 In the course of the year we have taken steps to enhance our processes for ensuring that all of our staff receive high quality training and development. Key changes include the following:
- a) Implementation of a departmental induction process, which formalises our approach to the development of new members of staff during their first months at TfL.
 - b) As part of this we have now introduced a requirement that new joiners into audit positions who do not have previous audit experience will be required to complete the IIA's Certificate of Internal Audit during their first year in the department.
 - c) We have developed a competency framework, based on the TfL one but tailored to our department, so that there is greater clarity for staff over the behaviours that are expected of them.
 - d) We have entered into an arrangement with an external trainer to assist us with a rolling programme of training to ensure that all staff keep their professional audit skills current. All of our staff attended training on Risk Based Auditing in December.
 - e) We have developed, in liaison with TfL's SAP Business Change and Improvement team, a one-day SAP training course specifically tailored to the needs of internal auditors. The majority of our audit staff attended this training during April 2008.
 - f) A number of our staff also underwent training during the year in the use of IDEA, which is software to enable analysis of large volumes of data. We anticipate that this will improve the efficiency of some of our audits.
 - g) Staff were also provided with training in the use of ARM, the risk management software which has been in use in LU for some time and is being rolled out to

other parts of TfL. The ability to use ARM will provide staff with easy access to risk information about the business, which will improve our audit planning process.

Co-sourcing

- 4.11 We continue to use Ernst & Young to supplement our resources under our existing contact. 7.8 per cent of time charged to audits in 2007/08 was provided by them. We have not needed to use any of the firms on our back-up framework during the year.

5 INTERNAL AUDIT PROCESSES

- 5.1 The Internal Audit Manual has been reviewed and updated this year, in particular following publication of the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom at the end of 2006.
- 5.2 The other major development in our approach is the Contract Audit Toolkit which was developed during the year and has now been fully introduced. Copies have been sent to Heads of Procurement so they understand our audit approach and we are implementing a method of measuring the effectiveness of the toolkit.
- 5.3 The purpose of the Toolkit is to ensure that auditors are adopting best professional practice in procurement and contract management audits. By referring to the toolkit, they will understand the key generic risks inherent in each point of the procurement cycle.
- 5.4 The toolkit is in two parts, the first part covers the procurement lifecycle. It gives a brief description of the cycle point, a typical scope, key risks, key questions to ask and discusses how sustainability and responsible procurement should be introduced and monitored.
- 5.5 Part two provides further detail on the nature of contract and contract law and also covers contract management and performance monitoring. This part of the toolkit is intended to be used as background material to assist those auditors who do not have a contract management background.

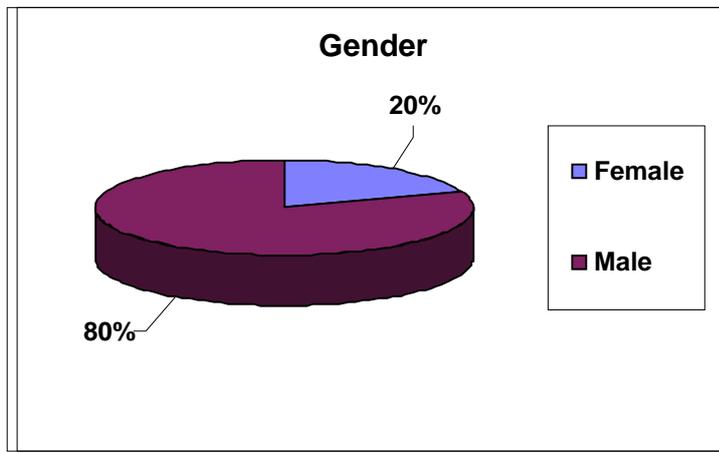
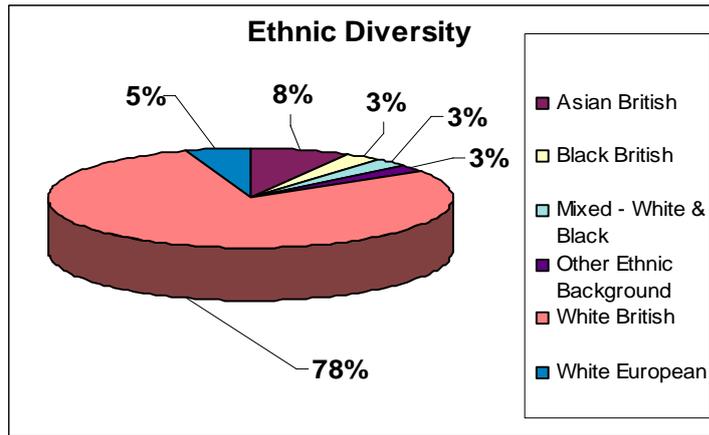
6 BENCHMARKING AND NETWORKING

- 6.1 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 as well as attending conferences relevant to our professional and business needs. The department has memberships of the 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 which assist in ensuring that we are up to date.

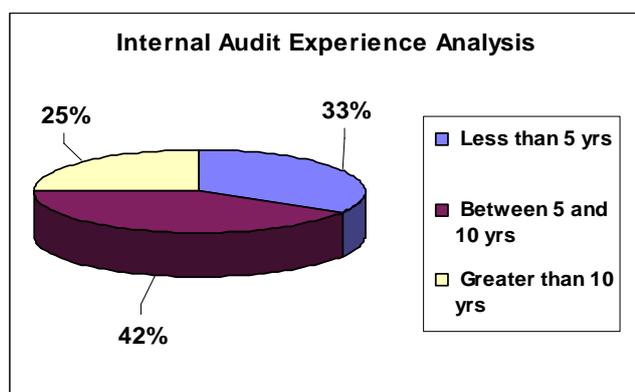
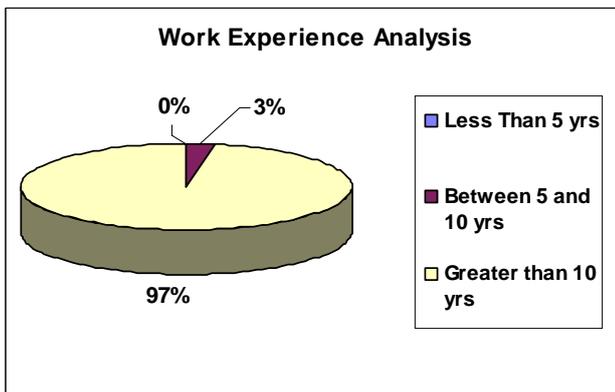
- 6.2 The Director of Internal Audit belongs to a number of Internal Audit networks, which frequently brings her into contact with other Heads of Audit to discuss current topics.
- 6.3 The Director of Internal Audit is also a member of the Institute of Chartered Accountants in England and Wales' Audit and Assurance Faculty, Internal Audit and Corporate Governance Committees.
- 6.4 During the year we have been contacted by a number of organisations wishing to talk to us about benchmarking their Internal Audit and Risk Management processes against what we do. These organisations have included: the Westfield Limited (international retail property group), the Child Support Agency, the Rail Procurement Agency (Dublin) and the Metropolitan Police Service.
- 6.5 Additionally, TfL Internal Audit has arranged and chaired a series of meetings with the Heads of Audit of the other members of the GLA family to both benchmark and discuss internal audit best practice and developments and how they are being applied throughout the GLA.
- 6.6 Our Senior Audit Manager – Projects has been working with the Association for Project Management to set up a Specific Interest Group (SIG), chaired by him, on the subject of project and programme assurance. A launch meeting was held on 3rd March 2008, attendance at which demonstrated strong interest from a wide variety of organizations. It is anticipated that this group will eventually develop best practice guidelines, and become an authority on how organizations like TfL can achieve optimum effectiveness and efficiency in their project and programme assurance activities. Others within TfL are also already involved in this new SIG, and we expect there to be some considerable benefit to various assurance functions within TfL, and to TfL's project and programme management community generally.
- 6.7 During the year, the Senior Audit and Investigations Manager – Fraud & Security was elected as Chair of the London Fraud Forum. This is an organisation formed in June 2007 and has a membership of over 250 fraud professionals representing most of the major public organisations and private companies in London. The Senior Audit and Investigations Manager – Fraud & Security is also on the Steering Group of the London Public Sector Counter Fraud Partnership. The fraud team are involved in other fraud related organisations including the Intellectual Property Crime Group and this year we have applied for corporate membership of the Fraud Advisory Panel. We also hosted a visit by a member of the Independent Commission Against Corruption from Hong Kong.

7 KEY PERFORMANCE INDICATORS IN 2007/08.

- 7.1 Our Equality and Diversity Statistics are:



7.2 We also measure work and specific Internal Audit experience as key indicators of the team's experience.



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 view 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 as an Appendix 1.

8.2 Our return rate for feedback forms has increased to 55 per cent from 48 per cent in the last two years. 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 is as follows:

	Strongly Agree	Agree	Disagree	Strongly Disagree
2005/06	56%	40%	4%	0%
2006/07	38%	53.5%	7.5%	1%
2007/08	35.2%	55.6%	7 %	2%

8.3 We received 5 'Strongly disagreed' scores across 3 audits. All feedback which 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.

APPENDIX 1

Customer feedback form – SUMMARY OF RESPONSES FOR 2007/08

	Question	1	2	3	4
1	Communication prior to the audit work was appropriate and I was aware of visit dates and objectives before the work started	18	17	4	1
2	Throughout the audit process I was kept informed of the work being done and issues arising	13	23	3	1
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)	12	24	3	2
4	Internal audit staff demonstrated a pragmatic and commercial approach to developing solutions to issues identified during the audit	8	27	3	0
5	The audit report was issued in a timely fashion and was a fair summary of audit findings and management responses	11	23	4	1
6	Internal audit staff acted in a professional manner throughout the assignment	22	19	0	0

Scale (please tick one): 1 = Strongly agree, 2 = Agree, 3 = Disagree, 4 = Strongly disagree

7. What did we do best? **Comments included:-**

‘The communication was excellent throughout the audit. All done in a very timely and efficient matter’; ‘You took time to understand the processes and engaged us with meetings and a series of drafts before reaching fair conclusions’; ‘ You gave us sufficient time to respond to management actions’

8. What could we have done better?

‘We suggest that the scoring system is introduced which would provide a target for improvement’; ‘Initial briefing could have been clearer’.