



INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

KPMG External Audit – 2007/08

Reliance on the work of Internal Audit

23 January 2008

AUDIT

External / Internal Liaison

We set out below details of how Internal Audit work contributes to KPMG's responsibility as external auditors to give an independent assessment of:

- whether the statement of accounts fairly present the financial position of Transport for London (TfL) and its income and expenditure account and balance sheet for the year in question and have been properly prepared in accordance with the relevant legislation; and
- whether TfL has put in place proper arrangements for ensuring economy, efficiency and effectiveness in its use of resources.

Statement of Accounts

Part of KPMG's approach is to understand the events and transactions that, in our judgement, may have a significant effect on the statement of accounts, supporting our accounts objective. At our interim audit this involves using our knowledge of the financial systems to identify and test the overall high-level controls, including manual and IT controls which provide assurance over the figures used to prepare the accounts. The scope of this work for our 2007/08 interim audit was provided to TfL in October 2007, setting out the high level controls which we would be reviewing.

As set out in the 'Liaison between Internal and External Audit' paper dated 21 November 2007, our work draws on that of Internal Audit where possible. TfL's Internal Audit plan is based on a risk based assessment which covers total business risk. Our reliance on internal audit focuses on work performed over the high level controls over key financial systems. There are a number of reviews performed to date which we will consider when planning our final accounts audit approach. We will continue to monitor internal Audit's finalised reports over the next month, and have planned to meet with Internal Audit in February to discuss issues which may impact on our final accounts audit approach.

During 2007/08, there are three specific areas where we are relying on the work of internal audit:

- IT general controls – The scope of our IT audit work covers only the financial reporting systems to support our opinion on the financial statements. Work performed by Internal Audit in respect of the Information Management effectiveness assurance review and the End to End Procure to Pay process review has been reviewed and meetings held with Internal Audit to discuss key findings and scope of follow up work. This means our IT audit work for the current year will focus on data analysis and testing of compensating controls in the SAP control environment, and is intended to cover only the high-risk areas of SAP where our prior year work has identified issues. This will include an assessment of the:
 - current state of the SAP controls which ensure that system administration settings are assigned in accordance with good practice to reduce the risk of unauthorised / inappropriate access; and
 - current state of the SAP controls which ensure that access to the system by users is appropriately restricted and configured in accordance with good practice. Our interim work on this was completed in November 2007.

Since then, we have met with TfL's Head of IM and Internal Audit's IM senior audit manager to discuss the scope of Project Versa and our ongoing liaison arrangements over the forthcoming year.

External / Internal Liaison

- Payroll – Internal Audit have completed their audit of the controls over payroll processes in 2007/08. The objective of this was to assess the effectiveness of the controls that are operating over the payroll process of the TfL Group. The scope of this work covered a number of areas including: the controls over the input and maintenance of master data; controls over the input of transactional data; controls over payroll runs; controls over the remittance of payments; and controls over outputs. We provided Internal Audit with the testing programme we would otherwise perform which Internal Audit have included within the scope of the review. As a result, no payroll testing has been performed during our interim audit this year. We are currently liaising with Internal Audit on arrangements for our review of this work, to ensure that full reliance can be placed on this and there are no findings which would cause us to alter our final accounts audit approach to payroll. Our review will include a re-performance, on a sample basis, of the testing performed by Internal Audit in accordance with International Auditing Standards to ensure that we reach the same conclusion.
- Procurement – the internal audit plan includes a significant amount of work on compliance with procurement policies and review of projects. We have taken into account the findings of the work performed during 2007/08. We are not aware of any findings to date which would cause us to amend our audit approach in this area and are planning to place reliance on internal audit's work in this area.

We have also met with Internal Audit's Fraud team during our interim audit, as part of our assessment of the risk of material misstatement of the financial statements due to fraud. We have noted the work which is being carried out by the team on fraud investigations, particularly over revenue protection activity and the National Fraud Initiative. There are no findings from these discussions which would cause us to alter our audit approach. We will continue to follow up on the work performed by Internal Audit in this area during our final accounts work.

Use of Resources

In assessing whether TfL has proper arrangements in place for ensuring economy, efficiency and effectiveness in its use of resources, the sources of assurance that we will consider include TfL's whole system of internal control as reported on in its Statement of Corporate Governance and any other work that we feel is necessary to discharge our responsibilities.

We will draw on the work of Internal Audit in their review of operations across TfL in forming our conclusions on Use of Resources.