

Date: 15 June 2012

Item 11: KPMG Review of Internal Audit Effectiveness

This paper will be considered in public

1 Summary

- 1.1 The purpose of this paper is to present to the Audit and Assurance Committee the proposed terms of reference for KPMG's forthcoming review of Internal Audit effectiveness.

2 Recommendation

- 2.1 **The Committee is asked to note the paper.**

3 Background

- 3.1 The Accounts and Audit (England) Regulations 2011 require there to be an annual review of the effectiveness of the system of Internal Audit. The Code of Practice for Internal Audit in Local Government in the United Kingdom also requires the Head of Internal Audit to review periodically the service against strategy and the achievement of aims and objectives.
- 3.2 Historically, TfL Internal Audit has operated on a three year cycle for effectiveness reviews, as agreed with the Audit and Assurance Committee, with an external review by KPMG every three years, and internal effectiveness reviews in intervening years.
- 3.3 KPMG's last effectiveness review was carried out in 2008. A review by KPMG was, therefore, due in 2011, but in view of the organisational change to the department that took place in the first half of 2011 this timing would not have been appropriate.
- 3.4 The attached paper sets out KPMG's proposed terms of reference for a review of Internal Audit to be carried out during July 2012. The terms of reference have been approved by the Director of Internal Audit, General Counsel, the Chief Finance Officer and the Chair of the Audit and Assurance Committee.
- 3.5 The findings from the review will be reported to the next meeting of the Audit and Assurance Committee.

List of appendices to this report:

Appendix 1 – Terms of Reference of the KPMG Review of Internal Audit.

List of Background Papers:

None.

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Review of internal audit Terms of reference

Transport for London

1. Background and purpose of review

Background and purpose of review

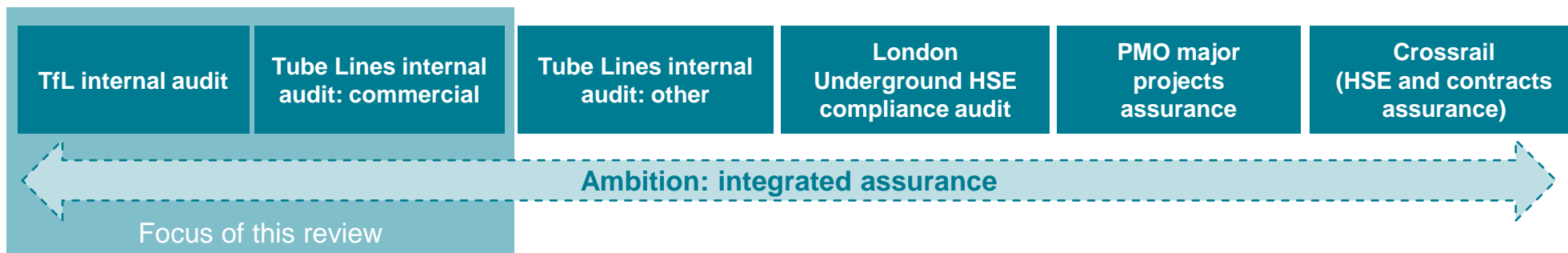
The effectiveness of an internal audit function should be routinely reviewed. For the benefit of both the function and those who rely on the assurances the function provides, annual internal or self-assessment should be supported with regular external assessments. The TfL internal audit function was last assessed externally in 2008.

The TfL internal audit function has seen significant changes over the past 2 years. Following a strategic review of the assurance arrangements in place resources were reconfigured resulting in a 25% reduction in the direct staff budget of the internal audit function. The most significant area of change was a reduction in the volume of audit work on major projects, in recognition of the investment programme assurance role of the PMO. TfL is also moving towards better aligning assurance sources and an integrated assurance plan for 2012/13, incorporating the work of Internal Audit and other assurance providers, was presented to the Audit Committee for approval in March. Enhanced reporting mechanisms to provide those charged with governance with oversight of all significant assurance activity are being developed.

The scope of this review has been agreed with the Director of Internal Audit, the Chief Finance Officer, General Counsel and the Chair of the TFL Audit Committee.

Other assurance providers

This review will focus on the TfL internal audit function and the commercial audit work at Tube Lines and will not cover other assurance providers. We are aware that a peer review involving Internal Audit and the HSE audit functions in London Underground and Tube Lines has just completed and we will review the outcomes from that piece of work. We understand that a similar peer review by Internal Audit of the project assurance function is planned for later in the year.



The work of the fraud team is excluded from the scope of the review as they are not involved in internal audit activity.

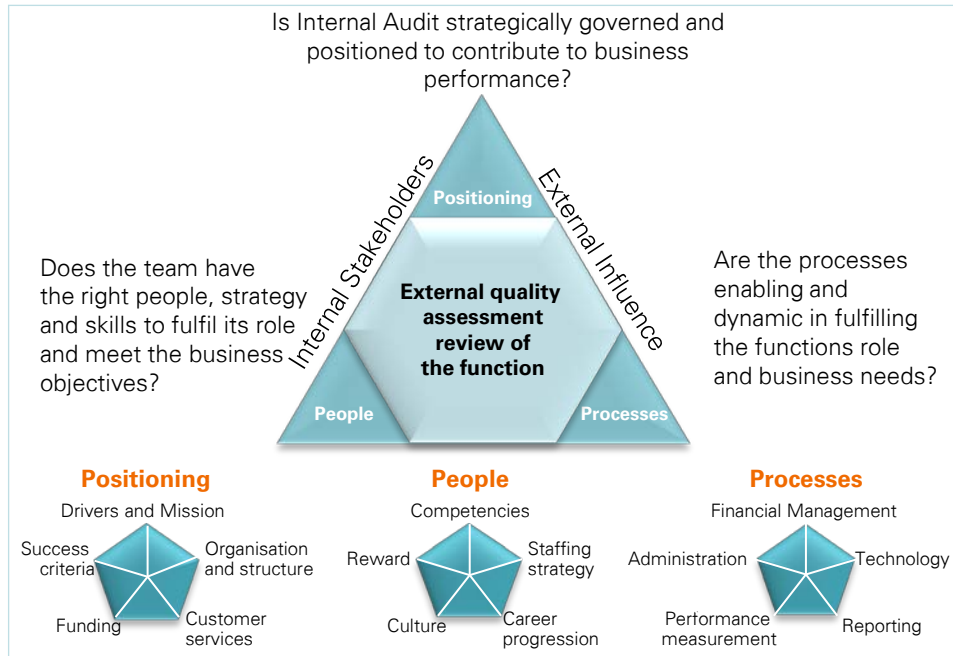
Important notice

These terms of reference do not constitute an engagement letter and no work will commence before the agreement and signing of an engagement letter.

2. Overview of our methodology

Our methodology

K'SPRInt (KPMG Strategic Performance Review of Internal Audit) is KPMG's methodology for undertaking reviews of Internal Audit functions and is underpinned by IIA standards. The focus of this review is to enable clear views to be formed on three main areas: *positioning, people* and *processes*.



We deliver this work in four main ways:

Consult with senior stakeholders	We will use a senior KPMG team with extensive assurance experience to interview senior people in your business. They will assess the value that IA currently delivers and establish where it can be developed both now and in the future. This will include internal stakeholders and external stakeholders including your external audit team. Section three includes a list of suggested interviewees.
Documentation review	We will review key Internal Audit documents and assess compliance with good practice. Examples of areas of review are the Internal Audit Charter, a detailed review of methodology, KPIs, stakeholder reporting. This will include a review of the progress made with integrated assurance reporting
Review of your quality control process	Your internal audit function completes an annual quality control review and self-assessment, reviewing a sample of files for compliance with your methodology and quality expectations. This includes completion of the IIA's Quality Assurance and Improvement Programme checklist. We will review this quality control process and complete a sample review of two internal audit files as part of this.
Advisory panel	We will share our initial assessment and recommendations with an Advisory Panel. The Advisory Panel will be comprised of relevant specialists – including leading internal audit practitioners - who will bring challenge and a broader perspective to our findings, ensuring recommendations are practical and appropriate.

Appendix A provides more detailed insights into the key areas explored under Positioning, People and Processes

3. Team

Core Team



Tamas Wood

The work will be led by Tamas Wood, an experienced Head of Internal Audit from our public sector assurance team in London.

In addition to his internal audit work, Tamas is a specialist in reviewing and advising on governance and assurance processes in the government and healthcare arenas.

Tamas will interview all senior stakeholders and be responsible for assessing your methodology and quality control processes.



Stuart Westgate

Stuart is a director in our Major Projects Assurance team and specialises in leadership of major infrastructure projects and programme. He has also led numerous strategic consulting assignments and project reviews and provides specialist assurance support to internal audits. Stuart was previously Director of Crossrail Surface.



John Lester

Tamas and Stuart will be supported by John Lester, a manager in our internal audit and assurance department. John has experience of working as an internal auditor and of reviewing internal audit functions.

Advisory panel



Andy Sayers

Andy heads up KPMG's internal audit practice for the public and not-for-profit sector. Andy has extensive internal audit experience across both the corporate and public sector and has also worked within KPMG's internal risk management function.

Andy's current internal audit clients include Schroders plc, a global asset manager, as well as the British Medical Association, the Royal College of Nursing and the Civil Aviation Authority. As such he is ideally placed to provide insight as to best practice across both the public and private sector.



Helen Charnley

A chartered member of the Institute of Internal Audit (CMIIA) and with an MSc Internal Audit and Management, Helen has significant experience of leading, managing and co-ordinating global internal audit services across a number of industries. Helen also delivers internal audit function reviews using the KSPRInt methodology across a range of industries.



Charlie Frieze

Charlie leads the IT audit and assurance services we provide to a range of our Internal Audit clients including National Savings & Investments and Balfour Beatty. This includes providing these clients with a wide range of reviews across the technology lifecycle including system development, IS service management and IT security. His sector experience includes: Property and Construction; Rail and Shipping; Local and Central Government; Health; and Banking.

4. Timetable and logistics

Timetable and deliverable

We propose to complete the fieldwork for this review in July 2012 and report in August 2012. Should the Olympics cause availability pressures for senior staff, we will work with you to revise the timeline.

Our key deliverable will be a tailored report, highlighting strengths and opportunities for improvement to meet the IIA standards and stakeholder expectations, classified according to the three key categories of positioning, people and processes. The report will include a prioritised action plan for any issues that need addressing.

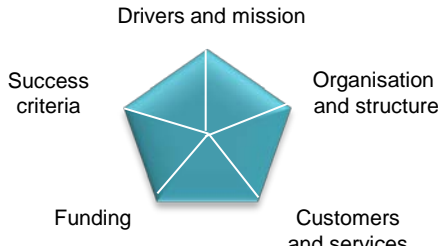
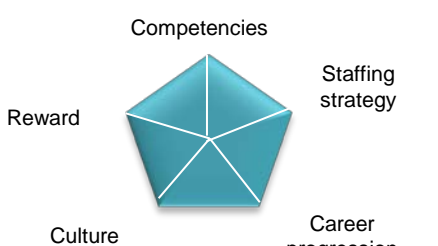
We will discuss and agree our findings with you to ensure there are no surprises. Our report will be agreed with the Director of Internal Audit and General Counsel.

Access to officers and documentation

We anticipate needing to meet with the following officers and stakeholders as part of this review:

- Steve Allen, Managing Director - Finance
- Keith Williams, Chair of the TfL Audit and Assurance Committee
- Howard Carter, General Counsel
- Stephen Critchley, Chief Finance Officer
- Clive Walker, Director of Internal Audit
- Senior Audit Managers
- Manisha Mehta, Commercial Auditor, Tube Lines
- Andrew Pollins, Finance Director- Rail and Underground
- Sarah Atkins, Director of Commercial, Rail and Underground
- Stuart Munro, Finance Director, Tube Lines
- David Waboso, Capital Programmes Director, London Underground
- David Hendry, Director of Finance – Surface Transport
- Mike Strezelecki, Director of Safety
- Garrett Emmerson, Chief Operating Officer – Surface Transport
- Steve Townsend, Chief Information Officer
- Andrew Quincey, Director of Commercial
- David Allen, Finance Director, Crossrail
- Heather Rabbatts, Chair of Crossrail Audit Committee
- Wayne Southwood, external audit partner

Appendix A: Detailed methodology

<p>POSITIONING</p> 	<p>Drivers and mission</p>	<ul style="list-style-type: none"> • Are the corporate drivers for the Function appropriate? Are the mission and role defined within a wider governance framework and are they effectively communicated?
<p>PEOPLE</p> 	<p>Organisation and structure:</p>	<ul style="list-style-type: none"> • Does the Function's structure promote objectivity, consistency and business understanding? Is the structure adaptable to changes in the business environment?
<p>PROCESSES</p> 	<p>Interaction with the business</p>	<ul style="list-style-type: none"> • Are the stakeholders, users and services of the Function agreed and are they appropriate to the needs of the business?
	<p>Reporting</p>	<ul style="list-style-type: none"> • Does the Function report in a way which is effective, has impact and promotes a strong control environment and compliance culture across the Group?
	<p>Success criteria</p>	<ul style="list-style-type: none"> • Is the Function valuable to the business? Are there defined success criteria and are they appropriate?
	<p>Competencies</p>	<ul style="list-style-type: none"> • Are the Function's core competencies directly related to its mission, role and scope of work?
	<p>Staffing strategy</p>	<ul style="list-style-type: none"> • Does the Function's staffing strategy reflect its mission, role and required staff competencies? Is the strategy sufficiently flexible to respond to change in demand?
	<p>Career progression</p>	<ul style="list-style-type: none"> • Does the Function have an established career progression programme that incorporates training and competency development?
	<p>Culture</p>	<ul style="list-style-type: none"> • Does the Function operate in a culture which fosters the achievement of its mission and the control environment of the Group?
	<p>Appraisal</p>	<ul style="list-style-type: none"> • Is the performance of individual personnel appraised against objectives which are aligned to the Functions' key performance indicators?
	<p>Risk assessment, planning and delivery</p>	<ul style="list-style-type: none"> • Does the Function implement a good planning methodology? Does the Function have an efficient and effective delivery framework which includes high quality documentation and reporting? To what extent do the members of the function co-ordinate their work to avoid duplication, and promote knowledge sharing? How far progressed is integrated assurance reporting?
	<p>Technology</p>	<ul style="list-style-type: none"> • To what extent does the Function take full advantage of information technology to enhance its operations?
	<p>Administration</p>	<ul style="list-style-type: none"> • What administration processes are in place to facilitate the smooth operation of the Function?
	<p>Performance measurement</p>	<ul style="list-style-type: none"> • Does the Function have an appropriate framework to measure its performance? Are the performance measures in line with its critical success factors?
	<p>Relationship management</p>	<ul style="list-style-type: none"> • To what extent are processes in place to help the Function manage its relationships with its key stakeholders? How good is the relationship between the Function and its key stakeholders?