

TRANSPORT FOR LONDON

AUDIT COMMITTEE

SUBJECT: KPMG LETTER ON INDEPENDENCE AND OBJECTIVITY

DATE: 15 JUNE 2010

1 PURPOSE

- 1.1 To report to the Audit Committee on the independence and objectivity of KPMG. The Audit Committee is requested to note this report.

2 BACKGROUND

- 2.1 KPMG is required to report annually to the Audit Committee on its independence and objectivity, taking into account guidance including the Audit Commission's Code of Audit Practice and Standing Guidance for Auditors.
- 2.2 KPMG has reviewed its procedures and the KPMG letter is attached for the Audit Committee's review.

3 RECOMMENDATION

- 3.1 The Audit Committee is recommended to NOTE the report.

4 CONTACT

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INFRASTRUCTURE, GOVERNMENT & HEALTHCARE

Transport for London

Report to those charged with governance – year ended 31 March 2010

7 June 2010

AUDIT

PRIVATE & CONFIDENTIAL

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Introduction

Purpose of this document

- This report summarises, for the benefit of those charged with the governance of Transport for London ('TfL' or 'the Corporation'), the key issues identified during the course of our audit of the consolidated accounts of the Transport for London Group for the year ended 31 March 2010. This report has been prepared for presentation to TfL's Audit Committee on 15 June 2010.
- The information included in this memorandum has not been verified except to the extent required for the purposes of our audit.

Scope of this report

- The Transport for London Group has a complex structure. TfL is a functional body of the Greater London Authority and KPMG LLP has been appointed to audit TfL by the Audit Commission. We are required to follow the Audit Commission's Code of Audit Practice ('the Code') in carrying out our audit of TfL, which covers all direct operations that are not delivered by TfL's wholly owned subsidiaries. As appointed auditors, we have statutory duties and responsibilities that are laid down in the Audit Commission Act 1998 and secondary legislation.
- TfL is required by statute to deliver certain services through registered companies. Transport Trading Limited ('TTL') is the holding company for these companies and TfL holds 100% of the equity shares of TTL. The individual accounts of TTL's subsidiary companies, as well as the consolidated accounts of the TTL Group are also audited by KPMG LLP. The accounts are prepared in accordance with the requirements of the Companies Acts and the audits are carried out in accordance with international auditing standards. The TTL Group includes the London Transport Museum, which was registered with the Charity Commission on 7 March 2008, and which has a wholly owned trading subsidiary, The London Transport Museum Trading Limited.
- The auditors of TfL rely on the work of the auditors of TTL to gain assurance on the truth and fairness of the TTL group accounts, which are consolidated with the accounts of TfL to form the consolidated accounts of the TfL Group. The TfL Group accounts also include the accounts of London Transport Insurance (Guernsey) Limited.
- There have been no significant changes to the Group structure during the year ended 31 March 2010.

Introduction (continued)

- The Code requires us to provide a summary of the work we have carried out to discharge our statutory audit responsibilities to those charged with governance (in this case the TfL Audit Committee) at the time they are considering the accounts. This duty applies to our statutory audit of the Corporation's accounts. In preparing our report, the Code requires us to comply with the requirements of ISA (UK & Ireland) 260 'Communication of Audit Matters to Those Charged With Governance' ('ISA 260'). In reporting the findings of our audits of the companies which comprise the TTL Group we are also required to comply with ISA 260.
- This report presents the matters arising from our audits of the Corporation's statutory accounts, the individual accounts of the companies included in the TTL Group and the consolidated accounts of the TfL Group.

Respective responsibilities of the appointed auditor and the audited body

Accounts and Annual Governance Statement

- It is the responsibility of the Corporation to put into place systems of internal control to ensure the regularity and lawfulness of transactions, to maintain proper accounting records and to prepare accounts that present a true and fair view of its financial position and its expenditure and income. The Corporation is also responsible for preparing and publishing with its accounts a statement on internal control within the Annual Governance Statement.
- We audit the accounts of the Corporation and the TfL Group and give our opinion as to whether they present a true and fair view of the financial position of the Corporation and the Group and its expenditure and income for the year in question and whether they have been prepared properly in accordance with relevant legislation and applicable accounting standards. We also consider whether the information presented in the Annual Governance Statement is consistent with the accounts and complies with statutory guidance.

Value for Money conclusion

- The Corporation is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources and regularly reviewing the adequacy and effectiveness of these arrangements. Our responsibility is to satisfy ourselves that the Corporation has put in place proper arrangements by reviewing and, where appropriate, examining evidence that is relevant to its corporate performance management and financial management arrangements and reporting on these arrangements.

Restriction on circulation and disclaimer

- This report is provided to the members of TfL's Audit Committee on the basis that it is for their information only and that it will not be quoted or referred to, in whole or part, without our prior written consent.
- This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than TfL) for any purpose or in any context. Any party other than TfL that obtains access to this report or a copy (under the Freedom of Information Act 2000 or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than TfL.

Status of audit

Audit status

- At the date of issue of this memorandum our detailed audit work is substantially complete subject to completion of the following:
 - Completion of post balance sheet events review prior to signature of the accounts
 - Review of final version of Statement of Accounts and Annual Report
- We have reviewed the draft Statement of Accounts and given comments to the finance team.
- There is one unadjusted audit difference set out in Appendix 1.
- Our proposed opinion on the accounts is presented in Appendix 2 to this report. The proposed opinion is unqualified.
- The Public Inspection Period will commence on 21 June 2010 and end on 16 July 2010. Local government electors will be able to address questions to KPMG, as the appointed auditor, from 19 July 2010 until completion of the audit on 23 July when the audit report is signed.

Accounts production and audit timetable

- The timetable for preparation of group and subsidiary company accounts was similar to the prior year, and deadlines have been met at each reporting level.
- The overall quality of working papers available to us for audit continues to be of a high standard. The finance teams and management were available to answer audit queries on a timely basis. In 2009, several of the new businesses acquired or formed by TfL during 2008/09 had difficulty in complying with the Group accounting timetable (in particular, the Nominee companies and London Transport Museum). There has been significant improvement in the quality of accounts prepared by these businesses this year, and in the timeliness of information available for audit.
- The quality of draft statutory accounts presented for audit was good, and the finance teams and audit teams work closely together to ensure disclosure requirements are met and the presentation adopted is helpful to the reader within the constraints of the prescribed disclosure requirements. The statutory accounts of subsidiary companies are due to be signed by 17 June 2010. At this point, all subsidiary companies are expected to meet this deadline.

Whole of Government Accounts ('WGA')

- Although we have combined some of our WGA testing with our audit of the accounts, our testing will not be completed until the WGA pack has been prepared by the group finance team. The deadline for submission of the WGA return to the Department for Communities and Local Government is 1 October 2010.

TfL Group and Corporation – Accounting Policies

Accounting policies

- The 2009 SORP introduced changes to the accounting approach for PFI/PPP schemes, which requires these schemes to be assessed under the requirements of International Financial Reporting Interpretation Committee (IFRIC) 12.
- In all other respects, the accounts have been prepared on the basis of policies consistent with the prior year.

IFRS

- Full adoption of IFRS is required for 2010/11, meaning 2009/10 accounts will be required to be restated for comparative purposes. For 2010/11, the Chartered Institute of Public Finance and Accountancy (CIPFA) has replaced the SORP with a Code of Practice which will be compliant with the Central Government Financial Reporting Manual and which will fall within the ambit of the Treasury's Financial Reporting Advisory Board.
- The key changes to the 2010/11 accounts, and subsequent actions needed, are expected to be around:
 - Leases – Under IFRS definitions of finance and operating leases have been amended. As a result, more leases will be classified as finance leases. All leases will need to be re-assessed against the new criteria and resulting changes to classification of leases made. In addition, all service contracts will need to be analysed for the existence of embedded leases.
 - Investment properties – There are differences under IFRS in the definition of investment properties which will require the TfL estate to be analysed for possible re-classification.
- To facilitate the convergence to IFRS, the Group finance team will also need to consider if changes are required to TfL's processes and systems and also the training needs of its staff. TfL has formed a working group to plan and direct the convergence and we are participating in working group meetings. We will continue to draw on our experience of assisting organisations in sectors which have already adopted IFRS in our work with TfL through the convergence process.

Conclusions on risks identified in audit plans

Methodology

The external audit plans for TfL and TTL for the year ended 31 March 2010, presented to the Audit Committee on 16 December 2009, set out audit risks identified during our planning process. We set out below our approach to auditing each of these items and conclusions reached.

Summary of opinion risks		
Opinion risks – TfL Group and Corporation	KPMG work	Conclusion
<p>The adoption of International Financial Reporting Standards (IFRS) is required by local government bodies for 2010/11. This will require the opening balance sheet as at 1 April 2009 and the financial statements for 2009/10 to be converted to IFRS for comparative purposes.</p> <p>TfL will also be required to account for PFI projects in accordance with IFRS in the 2009/10 group accounts under the 2009 SORP.</p> <p>There is also a requirement to prepare whole of government accounts (WGA) consolidation packs on the basis of IFRS for 2009/10.</p>	<p>The KPMG team has continued to work with the Group Finance's dedicated IFRS team to ensure that TfL is fully prepared for the conversion of IFRS for 2009/10 and 2010/11 accounts. This work is ongoing.</p> <p>Prior to our audit we reviewed accounting papers supporting TfL's proposed treatment of the respective PFI projects under IFRIC 12. We reviewed the accounting models supporting the IFRIC 12 adjustments and the required accounting entries.</p> <p>We will commence work on the WGA pack in September and have been working with the IFRS team to agree the methodology for this.</p>	<p>Our review of the PFI models found no errors and data had been correctly entered onto the ledger/consolidation schedules. Disclosures in the financial statements are in line with IFRIC12 requirements. The impact of the adjustment is explained on page 13.</p> <p>TfL remains on target to meet the IFRS conversion timetable. The restatement of the opening balance sheet as at 1 April 2009 will be audited in summer 2010.</p>
<p>The composition of the TfL Group expanded in 2008/09 with the addition of a number of new entities. Some of the finance teams within the new businesses found TfL's group accounting and audit timetable challenging.</p>	<p>We continued to work with TfL to ensure the finance teams within these entities were properly prepared to meet the timetable and our audit work was planned accordingly.</p>	<p>Despite tight deadlines and resourcing constraints all TfL Group entities, including those which were new in 2008/09, were able to meet all deadlines as set out in the Group accounting timetable. In addition, the quality of accounts, particularly those of the Nominee companies and London Transport Museum, was much improved.</p>
<p>Changes to the IM environment, for example, upgrade of the SAP system. The Nominee companies are scheduled to move onto the SAP system this year.</p>	<p>Our IT audit specialists worked closely with the TfL Internal Audit team to ensure that our IT audit approach was risk focussed.</p>	<p>The Nominee companies are now using the SAP system. We also note that the SAP access controls project has progressed during the year and controls around access rights have been improved.</p>

Conclusions on risks identified in audit plans (cont'd)

Summary of opinion risks		
Opinion risks	KPMG work	Conclusion
TfL has a significant investment programme aligned to its business plan and has assessed the associated funding requirements.	As part of our audit work we have reviewed TfL's forecasts for future investments and its future borrowings. We have also reviewed budget setting and monitoring processes.	Our work identified that despite cost pressures and pressures on cash flows TfL is continuing to forecast that it will deliver its investment programme within its borrowing limits. We noted that budget setting and monitoring processes were robust throughout the year.
<p>The majority of TfL's employees are members of the public sector section of the TfL Pension Fund. Given current market conditions assumptions used may cause the pension deficit to change significantly. A triennial valuation of the fund as at 31 March 2009 is currently in progress.</p> <p>Some Crossrail employees are also part of the Railway Pension scheme. Following the transfer of employment contracts of former Metronet employees, LUL took over the liability for the Nominee sections of the TfL Pension Fund. Given the current market conditions assumptions used may cause the pension deficit to change significantly.</p>	<p>Our pensions specialists considered the appropriateness of the valuation methodology and underlying assumptions used to calculate FRS17 disclosures.</p> <p>We reviewed FRS17 disclosures to ensure that they were adequate.</p>	Our work identified that the pensions assumptions used were within the ranges which KPMG's pensions specialists consider to be acceptable. Further commentary is included on page 14.
TfL is subject to significant claims from contractors in respect of projects and contracts, as well as disputes in the ordinary course of business (for example, on compulsory purchases). The assessment of the amount to be provided in respect of such claims is a highly subjective matter.	<p>The most material provisions in the Corporation's accounts were in relation to assets acquired under Compulsory Purchase Orders for the Crossrail project. Our property experts liaised with the TfL Property team to gain an understanding of the methodology used in estimating costs and to test a sample of transactions. We confirmed with the TfL Legal team that there were no other relevant claims that had not been provided for.</p> <p>We met with management and legal representatives to gain an understanding of provisions made and to assess whether estimates and judgements around these were reasonable.</p>	Based on detailed reviews undertaken by management, our discussions with the legal teams, verification of supporting correspondence and historical settlements we concur with management's assessment of the amounts accrued.

Conclusions on risks identified in audit plans (cont'd)

Summary of opinion risks		
Opinion risks – TTL Group	KPMG work	Conclusion
Accounting for the PPP and PFI contracts is a complex area. The accounting is driven from financial models, which calculate the profit and loss account impact. The charge for the year for the PPP contracts is also impacted by the level of abatements. These are adjustments made to the infrastructure service charge. Incorrect application of the models could lead to incorrect charges in the accounts. Inaccurate collection of abatement data and inaccurate processing could lead to an incorrect charge for the PPP.	<ul style="list-style-type: none"> • We have reviewed the output from the PPP and PFI models to ensure that the charge for the year is appropriate. • We have reviewed the management of the CUPID system which controls PPP abatements. • We have confirmed through our discussions with management that there have been no changes to the financial model. 	Our review of the output from the models and the CUPID system did not reveal any significant issues. We agree with the accounting treatment adopted for the PPP and PFI contracts.
On the majority of projects undertaken within TTL a judgement needs to be made concerning the split of costs between capital and operating expenditure. In many cases, projects will involve a mixture of repairs and maintenance (operating expenditure) and replacement (capital expenditure). Given the current economic environment there is an increased risk of projects being terminated or suspended, which increases the risk of potential write-offs of assets under construction. The treatment of costs associated with such projects will need to be carefully considered.	<ul style="list-style-type: none"> • We have reviewed the allocation of expenditure on a project by project basis for a sample of projects and had discussions with project managers. • We have tested the controls over managing capital expenditure and monitoring such expenditure. • We have discussed with management the details of terminated and/or suspended projects in the year and reviewed the treatment of associated costs. 	Based on our review of a sample of projects the allocation between capital and operating expenditure seems reasonable. We also note that controls over review and monitoring capital expenditure have operated effectively throughout the year Based on management's affordability and business plan reviews we note that costs of c£88m have been written off on projects stopped, delayed or reduced in scope.
A significant portion of revenue is collected through tube stations. The majority of the balance is collected through newsagents and managed by the Prestige contractor, Transys. TfL rely on data supplied through this system for recording such revenue in the accounts. Revenue is then allocated between the various modes based on survey data. In the absence of robust reconciliations, there is a risk of manipulation of revenue; this is significantly mitigated by the work of Internal Audit's fraud team.	<ul style="list-style-type: none"> • We have performed control testing over a sample of cash reconciliations performed at tube stations. We have verified the trail between daily ticket sales and cash collections. • We have also reviewed the allocation and apportionment process of revenue between the modes, based on survey data received from an independent source. • Our IT audit specialists have reviewed the revenue systems as part of their work. 	There were no significant observations arising from our controls testing on revenue reconciliations and our review of the revenue systems.

Conclusions on risks identified in audit plans (cont'd)

Summary of opinion risks		
Opinion risks – TTL Group	KPMG work	Conclusion
<p>Under the PPP contracts the related fixed assets remain on LU's balance sheet, because the balance of the risks and rewards is deemed to lie with LU. As a result, LU is dependent on Tube Lines to provide sufficient information on the costs incurred on those fixed assets during the year to enable LU to maintain its fixed asset register and prepare its accounts appropriately. Following the acquisition of the Nominee businesses last year, this enabled LU to reconcile all related balances with the Nominee companies.</p>	<p>We have discussed with management the approach to collating data from Tube Lines and confirmed our understanding from prior years.</p> <p>Following the acquisition of the Nominee businesses we have been able to agree amounts capitalised in LU to the project costs incurred in BCV and SSL</p>	<p>We note that there has been no change in the process of collating information from contractors in the year.</p> <p>We have agreed a sample of additions to asset returns from Tube Lines and to project spend in BCV/SSL with no significant discrepancies arising</p>
<p>The Group has a significant property portfolio and this represents a significant part of the assets on balance sheet. A number of properties received full external valuations. However a proportion of the portfolios is indexed by IPD (the property index) each year. In the current market the valuation of properties has been made much more difficult by the lack of comparable sales data.</p>	<ul style="list-style-type: none"> • We involved KPMG property specialists to review the property valuations at the year end • In addition, we reviewed the indexed properties and considered whether formal valuations were required. • All significant movements in valuations were reviewed. 	<p>The valuation methodology used including the rationale for indexation and impact of market conditions on development sites is consistent with prior years.</p> <p>There were no significant issues noted in respect of valuations.</p>
<p>Significant costs relating to the construction of Crossrail are capitalised on the balance sheet as assets under construction. These costs need to be recovered through the operation of the new railway. Given the nascent phase of the Crossrail project, we understand that there are no concrete plans in place to establish the mechanism or timing of this recovery at the moment.</p>	<ul style="list-style-type: none"> • We have discussed with management the current plan for operating Crossrail once the project is complete. • We have confirmed with the programme delivery team that only directly attributable costs are capitalised as part of the assets under construction. 	<p>We understand that current plans are that a private franchise operator is likely to be contracted to run the Crossrail operations. Crossrail will levy an access charge for use of the central section. The quantum of such access charges is yet to be determined, but it is the current intention that it is sufficient to allow for a recovery by Crossrail of its investment in the project. On this basis no impairment charge is deemed necessary. We note that the project is still in its early stages.</p>

Conclusions on risks identified in audit plans (cont'd)

Summary of opinion risks		
Opinion risks – TTL Group	KPMG work	Conclusion
<p>Within the TTL Group, London Underground ('LU') in particular has many large and complex contracts and considerable judgement is required in reviewing the status of projects and determining the quantum of provisions in respect of claims received. Provisions in respect of other liabilities are also subjective areas.</p>	<p>We have reviewed each of the key provisions with the TTL subsidiaries and discussed the status of projects and claims with management and the legal team. The provisions are estimated amounts based on claims received from contractors and management's assessment of the cost of settling those claims given information available at the time.</p> <p>Additional provisions have been made for voluntary severance. We have reviewed the basis of these and discussed them with management.</p>	<p>We are satisfied that management have taken account of developments during the year in estimating the amounts of the provisions. Provisions have been released appropriately where claims have been withdrawn or settled during the year.</p> <p>In March 2010 LU announced a re-organisation within the Operations area offering voluntary severance to certain targeted departments. A provision has been made based on management's best estimate of the likely take up. We have reviewed the documentation and the supporting workings and concur with management's assessment that there is a present constructive obligation that is probable and reliably measurable at the year end.</p>

Acquisition of Tube Lines Limited

Acquisition of Tube Lines Limited

- On 7 May 2010, TfL agreed to acquire the equity shares in Tube Lines Limited from Bechtel and Amey (Ferrovial) for £310 million. The acquisition is expected to complete by 30 June 2010. This will be disclosed in the TTL and TfL Group accounts for 2009/10 as a 'non-adjusting' post balance sheet event.
- Non-adjusting events are those that are the result of conditions that arose after the reporting date i.e. where circumstances have changed post year end. As the acquisition does not provide evidence of any conditions that existed at 31 March 2010 it is appropriate to treat this as 'non-adjusting'. The nature of the event and, if possible, an estimate of the financial effect will be disclosed in the accounts.
- As at 31 March 2010, there are a number of balances with Tube Lines Limited in LU's accounts, including the finance lease creditor, trading balances and provisions in respect of claims from Tube Lines Limited. Once agreement has been reached on settlement of these balances, we will liaise with the Group finance team on the appropriate accounting treatment.

IFRS adjustments in the 2009/10 accounts

Background

As part of its convergence towards International Financial Reporting Standards, TfL has been required by the SORP 2009 to change its accounting policy with respect to Private Finance Initiative ("PFI") schemes in the 2009/10 accounts. TfL has also restated prior year balances in respect of this change.

IFRIC 12 'Service Concession Arrangements' provides guidance on the accounting for PFI arrangements. Although IFRIC 12 applies to operators, the SORP requires that this guidance is used as the basis to determine whether PFI schemes should be recognised on the balance sheets of leasing bodies.

Scope

TfL's finance team has assessed leases and contracts and has concluded that the following are within the scope of IFRIC 12:

- A13 Thames Gateway
- Connect contract
- Prestige
- Power contract
- British Transport Police accommodation

Accounting treatment

The accounting treatment necessary to bring the assets related to the above schemes "on balance sheet" as at 1 April 2008 has been:

- 1) To assess the fair value of the assets as at the date they were completed;
- 2) To calculate the depreciated value of the assets as at 1 April 2008;
- 3) To calculate the liability due to the PFI operator as at 1 April 2008;
- 4) To calculate the difference between the depreciated value of the assets and the liability, and to allocate this to reserves.

These schemes have the following impact on the accounts for the years ended 31 March 2010 and 31 March 2009 respectively:

	2009/10	2008/09
	£m	£m
Total fixed assets	911	1,042
Net assets	421	377

Pensions

Key Issues	Commentary
<p>Background</p>	<ul style="list-style-type: none"> ● TfL provides pensions through seven arrangements: <ul style="list-style-type: none"> – the Public Sector Section of the TfL Pension Fund (“the PSS”) – the SSL section of the TfL Pension Fund (“the SSL section”) – the BCV section of the TfL Pension Fund (“the BCV section”) – the London Pensions Fund Authority Pension Fund (LPFA) which is a Local Government Pension Scheme (“LGPS”) – the Principal Civil Service Pension Scheme (“PCSPS”) – the London Underground section of the Railways Pension Scheme (“LURPS”) – the Omnibus section of the Railways Pension Scheme (ORPS) – the unfunded pension arrangements of TfL (“the unfunded arrangements”) ● The TfL Pension Fund is a defined benefit pension arrangement. Around 90% of TfL’s liabilities are in respect of the PSS, therefore we have concentrated our analysis on this section. ● The SSL and the BCV sections comprise a further 8% of TfL’s pension liabilities. Overall the assumptions for the SSL and the BCV sections were acceptable under FRS 17 at 31 March 2010 taking into account the particular nature of the sections. ● On 30 March 2010 the SSL and BCV sections were transferred into the PSS, therefore increasing the proportion of TfL’s overall pension liabilities in respect of the PSS to around 98%. ● The PCSPS is an unfunded multi-employer arrangement. TfL is unable to identify its share of the liabilities, and therefore treats its contributions as if they were to a defined contribution arrangement under FRS 17. ● We have not reviewed the accounting assumptions or results for the PCPS or the LURPS, while for the LGPS (which accounts for just over 1% of TfL’s total liabilities) we have reviewed the proposed assumptions only. ● Crossrail is part of the Omnibus section of the Railway Pension Scheme and has taken a multi-employer exemption in respect of this scheme. This leads to the pension scheme being accounted for as a defined contribution scheme rather than a defined benefit scheme. We concur with the level of disclosure currently in the accounts in relation to the scheme.
<p>Key assumptions</p>	<ul style="list-style-type: none"> ● Overall the financial and mortality assumptions proposed by TfL at 31 March 2010 are acceptable for the purposes of FRS 17, indeed, they are slightly more prudent than median market practice. ● We estimate that adopting assumptions in line with median market practice would decrease the liabilities by around £200m (or 3% of the liability). The life expectancy assumption has been updated following the 2009 actuarial funding valuation. This is now very close to market median, though still reflects the TfL Fund’s recent experience. ● The assumption for members exchanging pension for cash at retirement (i.e. the commutation assumption) has also been updated in light of the 2009 funding valuation. No allowance was made at 31 March 2009, whereas for 2009/10 it is assumed that 75% of members take the maximum lump sum allowed, which reflects a change in the funding assumptions. This is a reasonable approach, and is consistent with market practice as typically the majority of pension scheme members tend to take the maximum cash sum available to them. ● Overall the financial and mortality assumptions proposed at 31 March 2010 for the LGPS are acceptable for the purposes of FRS 17 however they are slightly stronger than median market practice.

Corporate Governance and key control issues

Statement of Corporate Governance and other disclosures in the Statement of Accounts

- We have received a draft of the Annual Governance Statement from management and have reviewed this. We have passed our comments to management for consideration.
- We have reviewed the Explanatory Foreword and Financial Review commentary in the Accounts, and are satisfied that this fairly reflects the Group's current position and developments during the year, for example, the comments on work performed in the year on treasury risk management.
- We have reviewed the Employees' remuneration disclosures relating to Group employees in note 5 to the Accounts. We are satisfied that the disclosure is supported by accurate working papers.

Key control issues

- In November 2009 the contract for the administration of the congestion charge was transferred from Capita to IBM. Our work did not identify any issues in relation to the data migration between the two providers
- However, between periods 8 and 13 insufficient data was received by TfL from IBM to allow TfL to complete a number of periodic controls including balance sheet reconciliations and bad debt provision calculations.
- As a result we performed additional substantive testing including a visit to IBM in Coventry to gain assurances over the balances in the accounts.
- The controls are now operating effectively.
- During our interim audit work we noted some minor issues across the remainder of the Group relating to the control environment and the IT environment and have raised these with the financial services centre team and finance teams in the relevant entities. These had been addressed by the time of our audit work on the final accounts.
- There are no further issues we wish to bring to the attention of the Audit Committee.

SAP – Segregation of Duties

- Our work in previous years identified a significant number of users with access to a wide range of SAP transactions that gave rise to a number of potential segregation of duties issues.
- As in previous years we identified a number of users with access rights who could theoretically process invoices (enter invoices into SAP), approve payments (by issuing a Goods Received Note) and/or amend vendor master data, although executing all three processes would require these users to access non routine functionality within SAP.
- Our testing this year of those users who have access to a range of transactions found that a small number of users had actually performed two or more processes on related transactions. However, we note specific mitigating controls in place within accounts payable that decrease the potential for non authorised transactions. For example, additional authorisation is required for invoices above threshold limits and additional authorisation is required for changes to the sensitive fields of vendor master records. As in previous years, we discussed these issues with management who are satisfied that these particular users have access to the three specific processes referred to above.
- We also reviewed the transactions carried out by the users with significant access rights and noted that none of these had used these inappropriately.

Corporate Governance and key control issues (Continued)

Reliance on internal audit

- We have been able to place reliance on Internal Audit work as planned to support our Use of Resources assessment. We use the reports generated by Internal Audit to inform our overall risk assessment of the organisation. However, no specific reliance on internal audit work for the purposes of the audit of the accounts was planned.

Fraud Risk

- We have discussed the risk of fraud and management's processes for managing the risk of fraud with senior management. The Director of Internal Audit regularly reports to the Audit Committee on this area. No additional matters were identified during the external audit.

Review of legal exposures

- We have had meetings with TfL's legal team, the Senior Audit and Investigations Manager (fraud and security) and LUL's legal team. No matters not already reported by management or Internal Audit were identified during the external audit.

Value for money conclusion and use of resources

Use of resources

- The Corporation is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources and regularly reviewing the adequacy and effectiveness of these arrangements. In addition to our report on the accounts, we are required by the Code to reach a conclusion on the adequacy of TfL's arrangements for securing economy, efficiency and effectiveness in the use of resources ('the VFM conclusion'). We reach this judgement by assessing TfL's corporate performance management and financial management arrangements against key criteria established by the Audit Commission as representing the minimum standards that should be achieved by an organisation with adequate arrangements in place.
- The new Government has announced that they will abolish Comprehensive Area Assessment. On 26 May 2010 the Audit Commission instructed auditors to cease work on Use of Resources assessments for 2010. However, work on the Use of Resources assessment completed by that date is to be used to inform the Value for Money conclusion. Our draft conclusion on value for money for 2009/10, which is unqualified, is attached in Appendix 2.
- The Audit Commission requires auditors to issue the Value for Money conclusion with no reference to Use of Resources scores.
- Prior to 26 May we had completed the initial assessment phase of our work reviewing TfL's evidence of performance in the year against the specified key lines of enquiry. We also attended a London-wide area challenge meeting for the auditors of London Boroughs and GLA Group bodies as required by the Audit Commission. Following that area challenge meeting, our assessment of indicative scores for TfL for 2010 showed improvement in several of the Key Lines of Enquiry. These were:
 - Financial Reporting (based on the significant improvement in the quality of accounts produced by those businesses where there were issues with the quality and timeliness of accounts in 2009, and in the anticipated signature of the statutory accounts of the subsidiaries and Group in line with Group reporting deadlines which are substantially earlier than those achieved by most local authorities);
 - Data quality and use of information (based on improvements secured through the introduction of a new data quality initiative in 2009/10 which has ensured a focus on key data streams supporting business critical performance indicators. This framework, supported by the newly established Data Quality Team, has delivered improvements in the consistency, accuracy and reliability of reported information.)
 - Good governance (based on demonstrable improvement in induction procedures and focus on the Code of Conduct, and the positive impact that the review of Committees and Panels carried out in 2009 has had in providing clarity on the objectives and focus of Committees and Panels to support decision making and improved outcomes throughout 2009/10); and
 - Risk management and internal control (based on continuing developments in risk management arrangements, and improved risk management training with high satisfaction scores. TfL was highly commended by Strategic Risk Magazine in their Enterprise-wide Risk Programme of the Year awards 2010. In addition, TfL's proactive management of the business risk relating to Tube Lines Limited through the Periodic Review process resulted in the announcement on 7 May of the acquisition by TfL of the equity shares in Tube Lines Limited.)
- The Audit Commission is likely to require auditors to carry out specific reviews to support the Value for Money conclusion for 2010/11. We will update TfL on the requirements once these have been announced by the Audit Commission.

Contents

- Appendices

1. Audit differences
2. Draft Independent Audit Report to Transport for London
3. Draft Management Representations

Appendix 1

Audit differences

Unadjusted audit differences							
		Revenue Account		Balance Sheet			
£'000	Description	Current Year	Reserves	Current Assets	Non-Current Assets	Current Liabilities	Non-Current Liabilities
17,600	The assets of the Public Sector Section of the TfL Pension Fund are overvalued because of incorrect inclusion of Additional Voluntary Contributions by actuaries.		Dr pension fund reserve			Cr pension liability	

In addition, a number of presentational amendments and re-classifications were identified, all of which have been processed by the relevant finance teams.

Draft Independent Audit Report to Transport for London

Opinion on the financial statements

I have audited the financial statements of Transport for London ('the Corporation') and the Transport for London Group ('the Group') for the year ended 31 March 2010 which comprise the Explanatory Foreword and Financial Review, the Corporation and Group Income and Expenditure Accounts, the Statement of Movement on the General Fund Balances, the Reconciliation of the Deficit/(Surplus) on the Corporation's Single Entity Income and Expenditure Account to the Surplus on the Group Accounts, the Statement of Total Recognised Gains and Losses, the Balance Sheets, the Cash Flow Statements and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to Transport for London, as a body, in accordance with Part II of the Audit Commission Act 1998. My audit work has been undertaken so that I might state to Transport for London, as a body, those matters I am required to state to it in an auditor's report and for no other purpose. To the fullest extent permitted by law, I do not accept or assume responsibility to anyone other than Transport for London, as a body, for my audit work, for this report, or for the opinions I have formed.

Respective Responsibilities of the Chief Finance Officer and the Auditor

The Chief Finance Officer's responsibilities for preparing the financial statements in accordance with applicable laws and regulations and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2009 are set out in the Statement of Responsibilities.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and the International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the financial statements give a true and fair view of the financial position of the Corporation and the Group in accordance with applicable laws and regulations and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2009.

I review whether the governance statement reflects compliance with 'Delivering Good Governance in Local Government: A Framework' published by CIPFA/SOLACE in June 2007. I report if it does not comply with proper practices specified by CIPFA/SOLACE or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered, whether the governance statement covers all risks and controls. Neither am I required to form an opinion on the effectiveness of the Corporation's corporate governance procedures or its risk and control procedures.

I read other information published with the financial statements, and consider whether it is consistent with the audited financial statements. This other information comprises the Annual Report. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Draft Independent Audit Report to Transport for London (continued)

Basis of audit opinion

I conducted my audit in accordance with the Audit Commission Act 1998, the Code of Audit Practice issued by the Audit Commission and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board.

An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Chief Finance Officer in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Corporation and the Group's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming my opinion, I evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In my opinion the financial statements of the Corporation and the Group give a true and fair view, in accordance with applicable laws and regulations and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2009, of the financial position of the Corporation and the Group as at 31 March 2010 and their income and expenditure for the year then ended.

Certificate

I certify that I have completed the audit of the accounts in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice issued by the Audit Commission.

June Awty, Senior Statutory Auditor

For and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

London

xx July 2010

Draft Independent Audit Report to Transport for London (continued)

Conclusion on arrangements for securing economy, efficiency and effectiveness

The Corporation's Responsibilities

The Corporation is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to regularly review the adequacy and effectiveness of these arrangements.

Auditor's Responsibilities

I am required by the Audit Commission Act 1998 to be satisfied that proper arrangements have been made by the Corporation for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires me to report to you my conclusion in relation to proper arrangements, having regard to relevant criteria specified by the Audit Commission for other local government bodies. I report if significant matters have come to my attention which prevent me from concluding that the Corporation has made such proper arrangements. I am not required to consider, nor have I considered, whether all aspects of the Corporation's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Conclusion

I have undertaken my audit in accordance with the Code of Audit Practice and am satisfied that, in all significant respects, the Corporation made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2010.

June Awty, Senior Statutory Auditor

For and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

London

xx July 2010

Appendix 3

Draft Management Representation letter

KPMG LLP
15 Canada Square
London
E14 5GL

Dear Sirs

This representation letter is provided in connection with your audit of the financial statements of Transport for London ("the Corporation") and its subsidiaries (together, "the Group"), for the year ended 31 March 2010, for the purpose of expressing an opinion as to whether these financial statements give a true and fair view (or 'present fairly, in all material respects') the financial position of the Corporation and Group and their income and expenditure for the year then ended in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2009: A Statement of Recommended Practice ("SORP").

I understand that auditing standards require you to obtain representations from those responsible for the preparation of the financial statements on matters that are material to your opinion.

I have made appropriate enquiries of officers of the Group with the relevant knowledge and experience. Accordingly, I confirm, to the best of my knowledge and belief, the following representations given to you in connection with your audit of the financial statements for the year ended 31 March 2010:

All the accounting records have been made available to you for the purpose of your audit and the full effect of all the transactions undertaken by the Group has been properly reflected and recorded in the accounting records in accordance with agreements, including side agreements, amendments and oral agreements. All other records and related information, including minutes of all management and Board meetings, have been made available to you.

I am not aware of any known actual or possible non-compliance with laws and regulations that could have a material effect on the ability of the Group to conduct its business and therefore on the results and financial position to be disclosed in the financial statements for the year ended 31 March 2010.

I:

- understand that the term "fraud" includes misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. Misstatements resulting from fraudulent financial reporting involve intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users. Misstatements resulting from misappropriation of assets involve the theft of an entity's assets, often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.
- acknowledge responsibility for the design and implementation of internal control to prevent and detect fraud and error.
- have disclosed to you my knowledge of fraud or suspected fraud affecting the Group involving:
 - management and those charged with governance;
 - employees who have significant roles in internal control; or
 - others where the fraud could have a material effect on the financial statements.
- have disclosed to you my knowledge of fraud, or suspected fraud, affecting the Group's financial statements communicated by employees, former employees, analysts, regulators or others.

Appendix 3

Draft Management Representation letter (continued)

- have considered and disclosed to you the risk of material misstatement of the financial statements as a result of fraud, or suspected fraud, and based on this consideration, believe that the financial statements are not materially misstated as a result of fraud.

I confirm the completeness of the information provided to you regarding the identification of related parties and regarding transactions with such parties that are material to the financial statements. The identity of, and balances and transactions with, related parties have been properly recorded and when appropriate, adequately disclosed in the notes to the financial statements. I am not aware of any other such matters required to be disclosed in the financial statements, whether under FRS 8 or other requirements.

- I am satisfied that the following provisions recognised within the financial statements represent management's best estimate of the likely financial effect of settlement of the following claims against the Group (having regard to applicable accounting standards):

In particular, in relation to the following balances within London Underground Limited, I confirm that:

- I have considered the £83.2m accrual against claims submitted by Tube Lines Limited in respect of station upgrades, delay event notifications and other active claims. This amount remains the best estimate of the likely amount of settlement of claims.
- I have considered the £28.1m provision recorded for settlement of amounts in respect of environmental harm which are likely to be claimed by Tube Lines Limited. This amount remains the best estimate of the likely amount of settlement of claims.
- I have considered the £2.7m provision recorded against the CBSO claim in relation to the advertising contract. This amount remains the best estimate of the likely amount of settlement of these claims.
- I have considered the provision of £35.5m for voluntary severance made in the current year and believe it is more likely than not that a present obligation exists and it is reliably measurable at the year end.

- Except as disclosed to you, I am not aware of any additional claims that are material to the financial statements that have been or are expected to be received.
- I have recorded or disclosed, as appropriate, all liabilities, both actual and contingent, and have disclosed in Note 29 to the financial statements all guarantees that have been given to third parties.
- Having made appropriate enquires I am satisfied that the actuarial assumptions underlying the valuation of pension scheme liabilities are consistent with my knowledge of the business. I further confirm that:
 - all significant retirement benefits, including any arrangements that are statutory, contractual or implicit in the employer's actions; arise in the UK and the Republic of Ireland or overseas; are funded or unfunded; and are approved or unapproved, have been identified and disclosed in the financial statements;
 - There have been no material settlements and curtailments; and
 - there are no pension schemes of any significance that have been excluded from the financial statements of the Group.

Yours faithfully

Stephen Critchley
Chief Finance Officer

Date _____