Audit and Assurance Committee

Date: 1 October 2013

Item 5: Annual Audit Letter 2012/13

This paper will be considered in public

1 Summary

1.1 To inform the Audit and Assurance of the draft Annual Audit Letter as prepared by KPMG.

2 Recommendation

2.1 **The Committee is recommended to note this paper.**

3 Background

3.1 The Annual Audit Letter prepared by KPMG summarises their conclusions on the Annual Statement of Accounts and Value for Money. KPMG's letter is attached for the Committee's review.

3.2 KPMG identified no unadjusted audit differences and issued unqualified opinions on the TfL financial statements and the Whole of Government Accounts return.

3.3 Final fees for the 2012/13 audit were £226,100, compared to a planned fee of £207,900 and fees of £391,122 for 2011/12. The reasons for the additional costs are well understood and the actions summarised in Appendix 2 of KPMG's report together with minor changes to TfL's year end processes and KPMG's audit processes mitigate the risk of future cost overruns as far as possible. The reduction from 2011/12 was a result of a cut in fees imposed by the Audit Commission.

List of appendices to this report:

Appendix 1 – KPMG's Annual Audit Letter

List of Background Papers:

None

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Transport for London

Annual Audit Letter 2012/13

September 2013

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled *Statement of Responsibilities of Auditors and Audited Bodies*. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document which is available on the Audit Commission's website at www.auditcommission.gov.uk.

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Robert Brent, the appointed engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, Westward House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SR or by email to complaints@audit-commission.gov.uk. Their telephone number is 0844 798 3131, textphone (minicom) 020 7630 0421.

Section one
Executive summary

Purpose

This Annual Audit Letter ('the letter') summarises the key issues arising from our 2012/13 audit at Transport for London (TfL). Although this letter is addressed to the Board members of TfL, it is also intended to communicate key issues to external stakeholders, including members of the public. The letter will also be published on the Audit Commission website at www.audit-commission.gov.uk. It is the responsibility of TfL to publish the letter on the TfL website at www.tfl.gov.uk. We have already reported all the issues in this letter to you throughout the year and a list of all reports we have issued is provided in Appendix 1.

Scope of our audit

The statutory responsibilities and powers of appointed auditors are set out in the Audit Commission Act 1998. Our main responsibility is to carry out an audit that meets the requirements of the Audit Commission's *Code of Audit Practice* (the *Code*) which requires us to review and report on your:

- use of resources – that is whether you have made proper arrangements for securing economy, efficiency and effectiveness ('value for money') in your use of resources. Our work in this area is summarised in section 2;
- accounts – that is the Financial Statements and the Annual Governance Statement. This work is summarised in section 2; and
- Whole of Government Accounts (WGA) – we issue an assurance statement to the National Audit Office in respect of TfL's financial information in our capacity of component auditor for the WGA. This work is summarised in section 2.

Key Messages

The key areas which we draw your attention to are:

- We issued unqualified audit opinions on the TfL Financial Statements and on its Value for Money Conclusion on 29 July 2013;
- We identified no unadjusted audit differences as part of our 2012/13 Financial Statement Audit;
- We have filed an unqualified opinion on the WGA.

We have attached our certification of closure of the audit in Appendix 4 of this document.

Acknowledgements

We would like to take this opportunity to thank officers and members for their continuing help and co-operation throughout our audit work.

Headlines

This section summarises our findings in all key elements of our statutory work in the financial year 2012/13.

VFM conclusion	We issued an unqualified value for money ('VFM') conclusion for 2012/13 on 29 July 2013. This means we are satisfied that you have proper arrangements for securing financial resilience and challenging how you secure economy, efficiency and effectiveness. To arrive at our conclusion we looked at your financial governance, financial planning and financial control processes, as well as how you are prioritising resources and improving efficiency and productivity.
Audit opinion	We issued an unqualified opinion on your financial statements on 29 July 2013. This means that we believe the financial statements give a true and fair view of the financial position of TfL (the Corporation and Group) and of its expenditure and income for the year.
Financial statements audit	We reported to TfL's Audit and Assurance Committee on 19 June 2013 in respect of the progress made in the audit of the financial statements. In all respects, we were able to complete our work as planned.
Audit adjustments	We identified no unadjusted audit differences. We identified a number of adjustments which were above our posting threshold but below our performance materiality threshold (both individually and in aggregate). The net impact of these adjustments was a £42.4m debit to the Group Comprehensive Income and Expenditure Statement primarily in relation to capital accounting matters in London Underground Limited. These were adjusted by TfL management.
Annual Governance Statement	We reviewed your Annual Governance Statement and concluded that it was consistent with our understanding.
Whole of Government accounts	We reviewed the consolidation pack which TfL prepared to support the production of Whole of Government Accounts by HM Treasury. We reported that the Authority's pack was materially consistent with the audited financial statements.
Performance improvements observations	In our ISA 260 communications to the Audit and Assurance Committee on 19 June 2013 we raised six priority recommendations as a result of our 2012/13 work. These are detailed in Appendix 2 together with the action plan agreed by management. We have also provided management with a more detailed list of other less high priority performance observations in a management letter. There are in total 19 observations covering the entire TfL group and management have provided responses to these and will take these forward as agreed.
Certificate	We issue our certificate as set out in Appendix 4 dated October 2013 and this confirms that we have concluded the audit for 2012/13 in accordance with the requirements of the *Audit Commission Act 1998* and the Audit Commission's *Code of Audit Practice*.
Audit fee	Our planned audit fees for the Corporation and Group (not including the underlying subsidiaries) audit for 2012/13 was £207,900 excluding VAT (2011/12 - £350,070). This fee does not include the underlying subsidiary entities. In addition to this fee we raised additional fees in 2012/13 of £5,200 in respect of the WGA audit work due to the scope changes, and additional fees of £13,000 due to delays in finalising audit work (subject to final determination by the Audit Commission). This compares to additional fees in 2011/12 due to extra work performed on congestion charging (£32,552) and on the WGA (£8,500). Note these figures exclude fees in respect of costs incurred due to responding to elector enquires. Further detail is contained in Appendix 3.

Appendix 1: Reports issued

We set out below the reports issued during the year.

2012

September

October

November

December

External Audit Plan (October 2012)

The *External Audit Plan* set out our approach to the audit of the Authority's financial statements and to work to support the VFM conclusion.

Audit Fee Letter (October 2012)

The *Audit Fee Letter* set out the proposed audit work and draft fee for the 2012/13 financial year.

2013

January

February

March

April

May

June

July

August

September

October

Report to Those Charged with Governance (June 2013)

The *Report to Those Charged with Governance* summarised the results of our audit work for 2012/13 including key issues and recommendations raised as a result of our observations.

We also provided the mandatory declarations required under auditing standards as part of this report.

Auditor's Report (July 2013)

The *Auditor's Report* included our audit opinion on the financial statements and our VFM conclusion.

Annual Audit Letter (October 2013)

This *Annual Audit Letter* provides a summary of the results of our audit for 2012/13 and includes our audit certificate.

Appendix 2: Key audit recommendations

This page outlines the issues we raised in our ISA 260, along with management responses:

No.	Issue and recommendation processes	Response/ responsible officer/ due date
1	***Property*** Currently there is a lack of formal documentation over the controls operated within the property division, and in particular how the operational reviews and procedures undertaken link to the financial reporting. In formally documenting all such processes the key controls over existence and completeness will be highlighted providing comfort that these key risks are fully covered in terms of the property assets recorded within SAP. An action plan has been agreed that will formally document all of the processes by the end of quarter 2, and this will be reviewed at that time to confirm that all relevant controls have been captured.	***Response*** A programme of work has been initiated to ensure congruency of records between the systems at TfL holding property related data. This includes updates of documentation relating to the improved processes. Good progress has been made and it is intended that a review of the actions completed and planned will be undertaken as part of the Interim Audit. ***Responsible Officers*** R Marshall, J Perham and M Hartland ***Due date*** Actions due between 7/13 and 2/14
2	***Accounts Payable*** Staff operating accounts payables controls had not followed document retention policies, in line with TfL procedures. We recommend all relevant staff are reminded of the need to retain documents securely, and of the importance of rigorous checks. At our suggestion, management have revised processes to enable electronic retention of documents.	***Response*** Supporting documentation in Accounts Payable is now electronically attached to the vendor record to ensure that they are retained securely. ***Responsible Officer*** Simon Bicknell ***Due date*** Completed 31/07/2013
3	***IT Controls*** Our IT audit specialists audited the key IT controls in place in the two main IT environments in the Group. We noted two key points: there continue to be issues with regard to the number of users granted superuser access rights to the core IT environment, while in another key environment the controls over access rights are not as robust as they could be, due to configuration issues. While these risks are mitigated by the controls operated outside the IT systems (e.g. regular reviews and reconciliations), and such controls on testing were found to be operating effectively, this remains an area where we recommend action is taken to reduce the inherent risk arising from these IT related matters. We have shared our detailed findings with the relevant management teams and actions are being developed to address the risks identified.	***Response*** A business wide project is in place which will deliver the following outcomes: Agreement on what constitutes a significant risk in the General Ledger ('GL') for TfL Re-definition and allocation of GL access to individuals to remove the risks as far as practically possible Identification of the mitigating business controls for those risks which remain. ***Responsible Officer*** Simon Bicknell ***Due date*** 30/11/2013

Appendix 2: Key audit recommendations (cont.)

This page outlines the issues we raised in our ISA 260, along with management responses:

No.	Issue and recommendation processes	Response/ responsible officer/ due date
4	***Cashflow monitoring*** There are various teams across the Group with responsibilities for monitoring cashflows, with TfL's Treasury Team having overall responsibility for the management of cash held with banks or other financial institutions. We recommend that a single central team performs a reconciliation of all TfL bank accounts on a monthly basis to SAP, and also ties these back to forecasts of monthly inflows and outflows. Meaningful narrative should be provided for any exceptional items. Management note the need for a single central team having responsibility for the coordination of all bank reconciliations and the FSC are working with Treasury towards designing and implementing a revised process. Management have noted that they will look further into improving reporting on variances between cashflow forecasts and actual periodic movements. We noted that whilst responsibility for the physical management of cash has been clearly assigned to the Treasury Team, Group-wide reconciliations between general ledger accounts, bank statements and detailed cashflow forecasts are not currently operating effectively. Compensating controls are in place at local levels. Internal audit have raised similar issues in recent reviews of these areas.	***Response*** A central team already exists and new processes have been implemented at the Financial Services Centre (FSC) to improve the quality of bank reconciliations, together with a revised responsibility matrix. ***Responsible Officer*** Simon Bicknell ***Due date*** Completed July 2013 ***Response*** Recommendation details in relation to forecasts are note, but cashflow is already closely monitored at business unit and group level, with established weekly and monthly reports of cash actuals vs forecast going to the CFO and MD Finance. ***Responsible Officer*** Simon Kilonback ***Due date*** Completed
5	***HR*** HR records are retained by local managers and are not always returned to the centre and retained. This has led to gaps in data and inconsistencies in the use of documents. Policies and procedures in this area require revision and the roles and responsibilities of the team centrally vis-a-vis the role of HR managers in the business requires clarification. Training should be provided to relevant officers. Management have informed us that they are in the process of producing easy to use guidance so that the business is aware of what should be held locally and what should be sent to HRS.	***Response*** We have put in place a strategy that will address a list of management actions by the end of March 2014. These include: • Developing a local HR Strategy that supports the overall TfL Information and Records Strategy • Developing and implementing a HR Disposal schedule • Developing processes and supporting documentation for employees and line managers that takes into account employment and pensions disposals. • Developing and delivering communications and training to HR staff and line managers in support of the processes • Developing and rolling out any additional training required to ensure that staff are equipped to manage HR information and records relating to staff and personal data effectively. ***Responsible Officer*** Stephen Field ***Due date*** End of March 2014

Appendix 2: Key audit recommendations (cont.)

This page outlines the issues we raised in our ISA 260, along with management responses:

No.	Issue and recommendation processes	Response/ responsible officer/ due date
6	***LUL Fixed Assets*** During the year the processing over the LUL fixed assets has moved across to the financial shared service centre. We commented in prior years on the informality of the controls operated within LUL with few processes being formally documented. This lack of formality has however been exposed in the transfer of processes where there is a need to transfer and embed processes. This has led to gaps in processes at year end (e.g. identification of assets to be disposed, and the assessment of capex versus opex for certain costs incurred), as highlighted in certain of the audit adjustments posted. Management have noted that they are aware of the additional actions required to ensure that the processes and assessment are fully embedded within the FSC. Management note that the established TfL project which has been implementing the changes in fixed asset processing will continue to provide oversight while these remaining items are embedded.	***Response*** Action plan in place to document key fixed asset processes and guidance to business accountants on likely triggers relating to assets transferred into service. Quarterly meetings are now in place to review status of projects, assets in service, disposals and impairments in addition to the periodic communication with business accountants. ***Responsible Officer*** Simon Bicknell/Richard Flanders ***Due date*** *31/12/2013*

Appendix 3: Audit fees

We have summarised below the outturn against the 2012/13 planned external audit fee.

External audit

Our final fee for the 2012/13 audit of TfL (excluding subsidiaries) was £226,100. This is an overall reduction of 42% percent (£165,022) on the comparative total fee for 2011/12 of £391,122.

The final fee compares to a planned fee of £207,900. The reasons for this variance are:

- an increased fee for the audit of the financial statements reflecting additional costs incurred in carrying out the final accounts audit of £13,000 over and above our initial estimate as at September 2012; and
- additional work required on our audit of WGA due to changes in collection methodology and scope from prior years (£5,200)

The revised estimated fee is subject to a final determination by the Audit Commission.

Other services

We performed non statutory audit work in the course of the year to a value of £196,145, contracted through the Corporation, as follows:

- £40,000 in respect of an ODA grant agreed upon procedures engagement;
- £95,545 in respect of bond issuance related activities;
- £21,600 controls assessments in respect of future congestion charging and traffic enforcement arrangements;
- £39,000 in respect of a review of internal audit effectiveness.

We also provided non-audit services as follows:

- £2,500 in respect of a VAT helpline;
- £3,950 in respect of payroll software licensing;
- £65,000 in respect of an advisory project relating to the Silvertown Tunnel .

This work was not related to our responsibilities under Audit Commission's *Code of Audit Practice*.

Appendix 4: Audit certification

Certificate

We certify that we have completed the audit of the financial statements of Transport for London Group and Corporation in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice 2010 for Local Government Bodies issued by the Audit Commission.

cutting through complexity