AGENDA ITEM 5

TRANSPORT FOR LONDON

AUDIT COMMITTEE

SUBJECT: EXTERNAL AUDIT PLAN TfL - YEAR ENDING 31 MARCH 2010

DATE: 16 DECEMBER 2009

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1 PURPOSE

1.1 To present to the Audit Committee KPMG's plan for the audit of the financial statements of Transport for London for the year ending 31 March 2010.

2 BACKGROUND

2.1 The Plan for TfL has been developed by the Appointed Auditor, KPMG, and sets out the work that they propose to undertake in the 2009/10 financial year. This encompasses work relating to financial statements as well as use of resources.

2.2 The Chief Finance Officer, Director of Internal Audit, and modal Finance Directors have been consulted on the Plans.

3 RECOMMENDATION

3.1 The Audit Committee is asked to NOTE the Plan and to make any comments as appropriate.

4 CONTACT

4.1 Contact: Sarah Bradley, Head of Group Financial Accounting
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Phone: 020 7126 4119

INFRASTRUCTURE, GOVERNMENT & HEALTHCARE

Transport for London

Accounts Audit Plan – year ending 31 March 2010

10 December 2009

AUDIT

AUDIT ▪ TAX ▪ ADVISORY

Concordat
Improving services
Reducing burden

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This report is addressed to Transport for London and has been prepared for the sole use of Transport for London. 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. 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 June Awty, who is the engagement partner to Transport for London, telephone 0207 311 1769 email june.awty@kpmg.co.uk who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 236 4000, email 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 Investigation Officer, Westward House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SR or by e mail to: complaints@audit-commission.gov.uk. Their telephone number is 0844 798 3131, textphone (minicom) 020 7630 0421

Summary

Our audit is divided into:

- **financial statements, audit; and**
- **use of resources assessment.**

This document describes how we will deliver our audit for Transport for London

This plan has been developed by the Appointed Auditor, KPMG LLP. It sets out the audit work that we propose to undertake in the 2009/10 financial year. This plan will be published on the Audit Commission's website.

Our statutory responsibilities and powers are set out in the Audit Commission Act 1998 and the Commission's *Code of Audit Practice* (*the Code).*

The Code summarises our responsibilities into two objectives, requiring us to review and report on your:

- *financial statements (including the Annual Governance Statement)*: providing an opinion on your accounts; and
- *use of resources*: concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the value for money conclusion).

The audit planning process for 2009/10, including the risk assessment, is an ongoing process and will continue as the year progresses, and the information in this plan will be kept under review and updated as necessary.

This plan relates to the audit of the Transport for London Corporation and Group. It does not include the plan for Transport Trading Limited ('TTL') and its subsidiaries, which is set out in a separate document.

Our Responsibility	Proposed work and output
Financial Statements and Annual Governance Statement (*page 3*)	• Review of the controls over the completion of the accounts. • A detailed audit of the accounts and annual governance statement. • ***The findings from this work support the audit opinions we issue on your financial statements.***
Use of Resources (*page 4*)	• **Use of Resources Assessment** of managing finances, governing the business and managing resources. These judgements are combined to give an overall use of resources score. • ***The results of this work will inform our value for money conclusion.***

Audit overview

We undertake our work on your financial statements and Annual Governance Statement in four key stages.

Our work results in our audit opinion on your financial statements.

We will carry out our audit of the financial statements in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (APB).

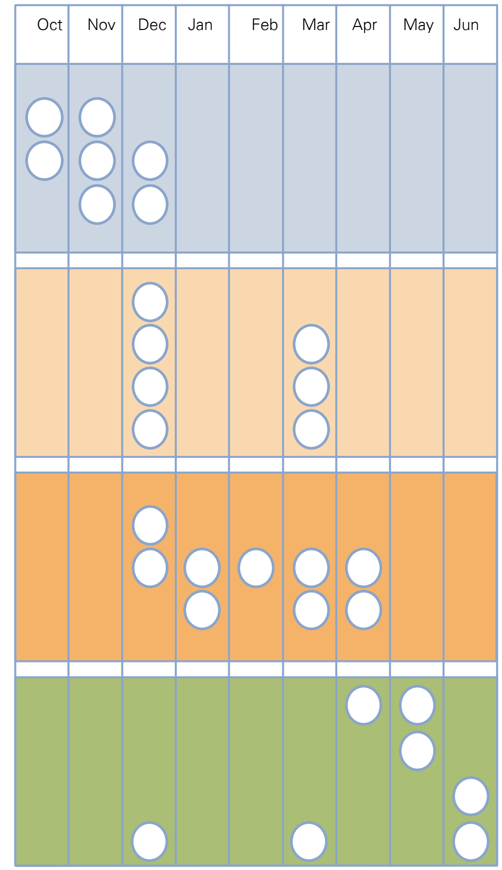
We will issue an opinion on whether the financial statements present fairly, in accordance with applicable laws and regulations and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2009, the financial position of TfL as at 31 March 2010 and its income and expenditure for the year.

We are also required to review whether the Annual Governance Statement has been presented in accordance with relevant requirements, and to report if it does not meet these requirements or if it is misleading or inconsistent with our knowledge of TfL.

Our Audit Process

We have summarised the four key stages of our financial statements audit process below:

1	**Planning**	• Perform risk assessment procedures and identify risks • Determine audit strategy • Determine planned audit approach
2	**Control Evaluation**	• Understand accounting and reporting activities • Evaluate design and implementation of selected controls • Test operating effectiveness of selected controls • Assess control risk and risk of serious mis-statement of the financial statements
3	**Substantive procedures**	• Plan substantive procedures • Perform substantive procedures • Consider if audit evidence is sufficient and appropriate
4	**Finalisation**	• Perform completion procedures • Perform overall evaluation • Form an audit opinion • Audit Committee reporting



Key financial statement audit risks

We are committed to targeting our work where it will have the greatest effect, based upon assessment of risk of mis-statement of the financial statements. This means planning our audit work to address areas of risk relevant to our audit responsibilities.

Our risk assessment process starts with the identification of the significant financial and operational risks applying at TfL with reference to:

- our cumulative knowledge of TfL;
- guidance issued by the Audit Commission;
- the specific results of previous and ongoing audit work;
- interviews with TfL officers; and
- liaison with internal audit.

Our risk assessment at this stage is based on the results of the 2008/09 audit. At this stage we are aware of the following risks that are likely to impact on the audit of the financial statements of the Corporation and Group.

Financial statement risks which relate primarily to the companies in the TTL group are covered in the TTL audit plan and not repeated in this document.

Summary of opinion risks

Opinion risks	Response
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. TfL will also be required to account for PFI projects in accordance with IFRS in the 2009/10 group accounts under the 2009 SORP. There is also a requirement to prepare whole of government accounts (WGA) consolidation packs on the basis of IFRS for 2009/10.	KPMG will continue to work with the Group Finance team to ensure that TfL is fully prepared for the conversion of IFRS for 2009/10 and 2010/11 accounts. We have already reviewed accounting papers supporting TfL's proposed treatment of the respective PFI projects under IFRIC 12. We will review the accounting models supporting the IFRIC 12 adjustments and the required accounting entries.
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.	We will continue to work with TfL to ensure the finance teams within these entities are properly prepared to meet the timetable and audit work is planned accordingly.
Changes to the IM environment, for example, upgrade of the SAP system.	We will work with the Internal Audit team to ensure our IT audit approach is risk focussed and takes account of changes introduced during the year.
TfL has a significant investment programme aligned to its business plan and has assessed the associated funding requirements.	KPMG will continue to assess the development and implementation of robust processes for monitoring and controlling the increased levels of capital investment and borrowing.

Key financial statement audit risks (continued)

We are committed to targeting our work where it will have the greatest effect, based upon assessment of risk of mis-statement of the financial statements. This means planning our audit work to address areas of risk relevant to our audit responsibilities.

Summary of opinion risks (ROSS/SARAH)

Opinion risks	Response
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.	We will work with our pensions specialists to consider the appropriateness of the valuation methodology and underlying assumptions. We will review relevant FRS 17 disclosures in the financial statements
TfL will make purchases of land on behalf of Crossrail, some of which will be retained under TfL's ownership.	We will work with internal audit to ensure appropriate controls are in place over such purchases. We will agree the accounting treatment for initial recording and ongoing valuation of these assets with the group finance team.
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.	We will discuss the basis for assessment of amounts provided in respect of claims with management and the legal teams. We will review available evidence which supports the assessments made.

Materiality

Our audit work is planned to detect errors that are material to the financial statements (of the TfL Corporation and of the TfL group) as a whole. We consider quantitative and qualitative factors in setting materiality and in designing our audit procedures. To comply with auditing standards, we report to the Audit Committee on:

- adjusted audit differences
- unadjusted audit differences
- disclosure differences

Reliance on Internal Audit

We have reviewed the Internal Audit plan for 2009/10 and have identified how the work of Internal Audit will impact on our audit approach during the year. We have categorised this into three areas: reviews where we plan to rely on the work of internal audit; reviews where we plan to work jointly with Internal Audit; and reviews which will inform our audit approach.

We will liaise with Internal Audit on arrangements relating to Crossrail and others as these develop during the forthcoming year. In addition, we will continue to liaise with TfL's IT auditors on IM systems and strategy reviews where appropriate.

There are a number of reviews which are scheduled to be performed across the year which will inform our accounts audit approach and assessment of TfL's arrangement over its Use of Resources. These span across the group and relate to specific risks. The reviews include financial health checks, procurement, risk management, contract management, partnership governance and claims management audits.

Key financial statement audit risks (continued)

We are committed to targeting our work where it will have the greatest effect, based upon assessment of risk of mis-statement of the financial statements. This means planning our audit work to address areas of risk relevant to our audit responsibilities.

Post balance sheet events

The auditor is required to perform audit procedures on all events up to the date of the auditor's report which may require adjustment to, or disclosure within, the financial statements to 31 March 2010.

The timetable for the 2008/09 financial statements and audit process provided for the Group financial statements to be approved by the Board on 24 June 2009, and for all subsidiary company statutory accounts to be signed prior to that date. The timing of signature of the audit opinion on the TfL Group financial statements is determined by the dates set by TfL for the Public Inspection Period, as the opinion cannot be signed until the Public Inspection Period has closed.

The timing of signature of the audit opinion on the 2009 financial statements for the Group, and approval of accounts by the Boards of TTL and London Underground Limited and issue of audit opinions was delayed to 31 July due to the need to assess the potential impact on the financial statements of a major claim received by London Underground Limited prior to approval of their accounts.

In setting the timetable for the 2009/10 financial statements, TfL should consider the likelihood of a significant event arising and the optimum timing of the Public Inspection Period.

Value for money conclusion

The code requires us to issue a conclusion on whether TfL has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money conclusion.

In arriving at this conclusion, we consider a standard set of criteria issued by the Audit Commission. Where relevant work has been undertaken by other regulators, we will normally place reliance on their reported results to inform our work.

We will also follow up on work from previous years to assess progress.

Use of resources assessment

KPMG will complete a Use of Resources assessment, as specified by the Audit Commission, in 2010.

The new assessment criteria introduced in 2009 emphasised the importance of improved value for money outcomes for local people. It is based on wider considerations other than cost and performance. It also looks at how commissioning and procurement are improving efficiency and how non-financial resources are used to support value for money. The overall judgement is based upon the evidence from three themes (managing finances, governing the business and managing resources) and gives particular emphasis to the value for money outcomes being achieved.

The Audit Commission plans to publish national reports on 17 December 2009 summarising the results of auditors' work on the 2008/09 accounts and the use of resources scores at local authorities, police authorities and fire and rescue authorities. The Audit Commission also plans to publish examples of strong performance and outcomes to support learning for the 2009/10 assessment. We will review that information when it is published and assist TfL management to plan its input to the 2010 assessment process.

In order to provide certainty and clarity about the assessment framework in year 2, there will be minimal changes for 2009/10. In particular, there will be no changes to the Key Lines of Enquiry. The Commission expects auditors to take a proportionate and risk-based approach that builds on the work done for 2008/09. The timeline for reporting will be brought forward, with final submissions of scores by auditors by 30 July and completion of the Audit Commission's National Quality Assurance process by 27 August 2010.

The work required to arrive at the use of resources assessment is aligned with that required to arrive at the auditor's value for money conclusion. The auditor's scores are reported to the Commission and are used as the basis for its overall use of resources judgement for the purposes of Comprehensive Area Assessment.

Data quality

The Audit Commission has specified that auditors will be required to undertake audit work in relation to data quality to support their use of resources assessments for 2009/10. We expect this to be similar to the approach taken in 2008/09 which required risk based spot checks of a sample of performance indicators.

Other work specified by the Audit Commission

Other audit work

Whole of government accounts (WGA)

We are required to review and report on your WGA consolidation pack in accordance with the approach agreed with HM Treasury and the National Audit Office. The 2009/10 WGA consolidated pack will need to be produced in accordance with International Financial Reporting Standards (IFRS).

National Fraud Initiative (NFI)

TfL participates in the National Fraud Initiative, which is the Audit Commission's computerised data matching exercise designed to detect fraud perpetrated against public bodies.

Certification of grant claims and returns

KPMG will continue to certify TfL's claims and returns on the following basis:

- claims below £500,000 will not be subject to certification;
- claims over £500,000 will be subject to a certification approach relevant to our assessment of the control environment and management preparation of claims. A robust control environment leads to a reduced certification approach for these claims.

The Audit Team

The audit team will be assisted by other specialists within KPMG as necessary.

Name	Contact details	Responsibilities
June Awty Senior Statutory Auditor	june.awty@kpmg.co.uk 020 7311 1769	Responsible for the overall delivery of the audit including the quality of outputs, signing the opinion and conclusion, and liaison with the Transport Commissioner, Chief Officers and the Audit Committee
Greg McIntosh Audit Director	greg.mcintosh@kpmg.co.uk 020 7311 6430	Advises on technical accounting and auditing issues and manages CIPFA and Audit Commission liaison
Ross Tudor Senior Audit Manager	ross.tudor@kpmg.co.uk 020 7311 4251	Manages and co-ordinates the different elements of the audit work across the TfL group
Neil Hewitson Senior Audit Manager	neil.hewitson@kpmg.co.uk 020 7311 1791	Responsible for the Use of Resources assessment 2010
Rebecca Pett Audit Manager	rebecca.pett@kpmg.co.uk 020 7311 4031	Responsible for the delivery of the different elements of the audit work (TfL Corporation and group)
Sarah Green Audit Manager	sarah.green@kpmg.co.uk 020 7311 6535	Responsible for the delivery of the different elements of the audit work (TfL Corporation and group)

Other information

Planned outputs

Our reports will be discussed and agreed with appropriate officers before being issued to the Audit Committee.

Planned reporting	Indicative date
Report on financial statements to those charged with governance	June 2010
Opinion on the financial statements and value for money conclusion	July 2010
Annual audit letter	September 2010
Use of resources report	September 2010

Independence and objectivity

We are not aware of any relationships that may affect the independence and objectivity of the Appointed Auditor and the audit staff, which we are required by auditing and ethical standards to communicate to you.

We comply with the ethical standards issued by the APB and with the Commission's requirements in respect of independence and objectivity as summarised at Appendix 2.

Audit fees

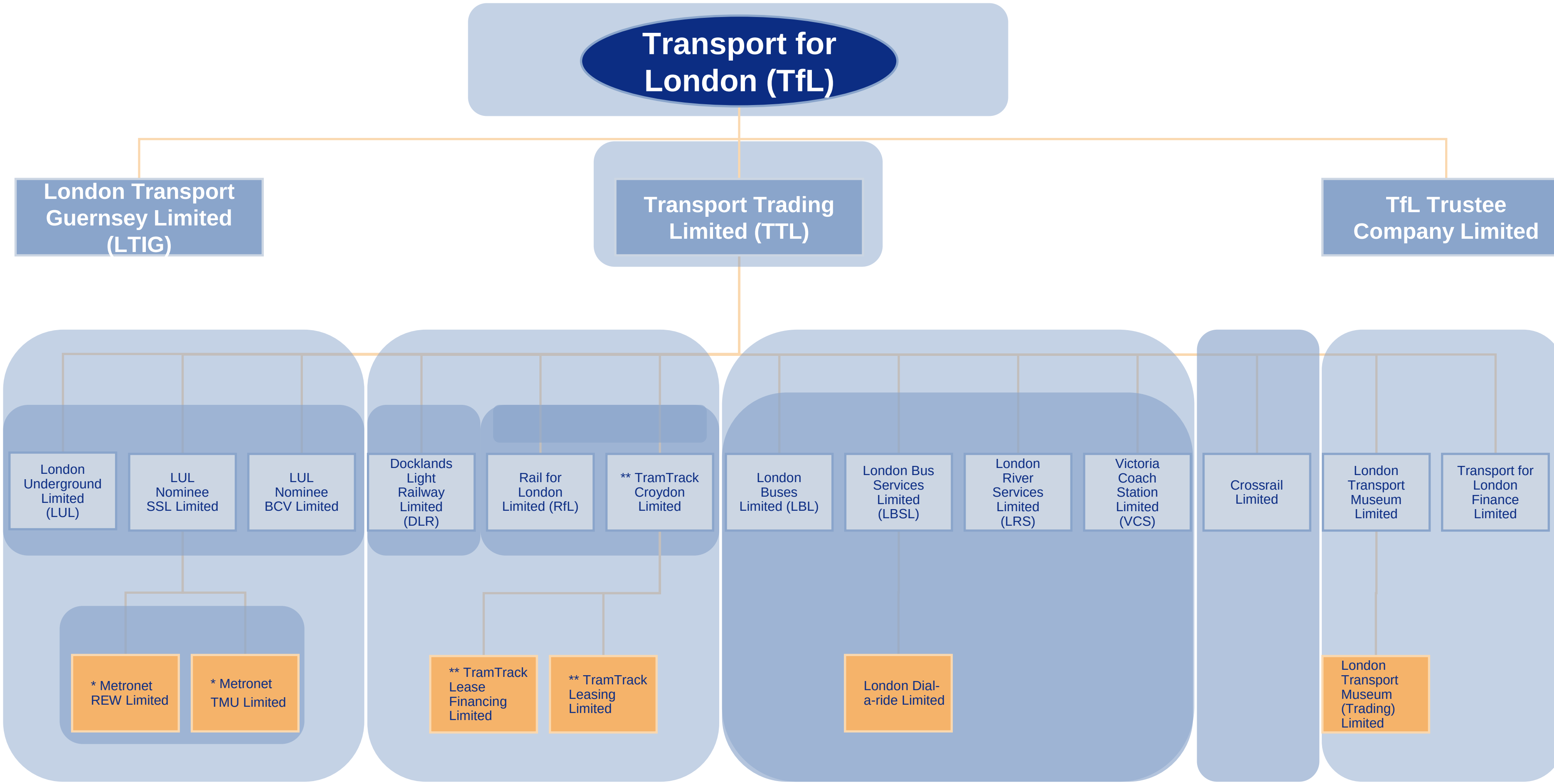
The audit fee proposal was set out in a letter to the Chief Finance Officer dated 30 June 2009, and considered at an Audit Committee meeting on 29 September 2009.

Quality of service

We are committed to providing you with a high quality service. If you are in any way dissatisfied, or would like to discuss how we can improve our service, please contact the Relationship Manager at the Audit Commission (Ken Davis, k-davis@audit-commission.gov.uk) or Appointed Auditor in the first instance.

If we are unable to satisfy your concerns, you have the right to make a formal complaint to the Audit Commission. The complaints procedure is set out in the leaflet *Something to Complain About* which is available from the Commission's website or on request.

TfL organisation structure



*	These entities became dormant on 31 March 2009
* *	It is intended that these entities will become dormant on 31 March 2010

Independence and objectivity

Auditors appointed by the Audit Commission are required to comply with the Commission's Code of Audit Practice and Standing Guidance for auditors, which defines the terms of my appointment. When auditing the financial statements auditors are also required to comply with auditing standards and ethical standards issued by the Auditing Practices Board (APB).

The main requirements of the Code of Audit Practice, Standing Guidance for Auditors and the standards are summarised below.

International Standard on Auditing (UK and Ireland) 260 (communication of audit matters with those charged with governance) requires that the appointed auditor:

- discloses in writing all relationships that may bear on the auditor's objectivity and independence, the related safeguards put in place to protect against these threats and the total amount of fee that the auditor has charged the client; and
- confirms in writing that the APB's ethical standards are complied with and that, in the auditor's professional judgement, they are independent and their objectivity is not compromised.

The standard defines 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case, the appropriate addressee of communications from the auditor to those charged with governance is the audit committee. The auditor reserves the right, however, to communicate directly with the authority on matters which are considered to be a sufficient importance.

The commission's Code of Audit Practice has an overriding general requirement that appointed auditors carry out their work independently and objectively, and ensure that they do not act in any way that might give rise to, or could reasonably be perceived to give rise to, a conflict of interest. In particular, appointed auditors and their staff should avoid entering into any official, professional or personal relationships which may, or could reasonably be perceived to, cause them inappropriately or unjustifiably to limit the scope, extent or rigour of their work or impair the objectivity of their judgement.

The Standing Guidance for Auditors includes a number of specific rules. The key rules relevant to this audit appointment are as follows:

- Appointed auditors should not perform additional work for an audited body (i.e. work over the above the minimum required to meet their statutory responsibilities) if it would compromise their independence or might give rise to a reasonable perception that their independence could be compromised. Where the audited body invites the auditor to carry out risk-based work in a particular area that cannot otherwise be justified as necessary to support the auditor's opinion and conclusions, it should be clearly differentiated within the audit plan as being 'additional work' and charged for separately from the normal audit fee;
- auditors should not accept engagements that involve commenting on the performance of other auditors appointed by the Commission on Commission work without first consulting the Commission;
- the engagement partner responsible for the audit should be changed at least once every five years..
- Audit suppliers are required to obtain the Commission's written approval prior to changing any engagement lead in respect of each audited body.
- The Commission must be notified of any change of second in command within one month of making the change. Where a new engagement lead or second in command has not previously undertaken audits under the Audit Commission Act 1998 or has not previously worked for the audit supplier, the audit supplier is required to provide brief details of the individual's relevant qualifications, skills and experience.
- the Appointed Auditor and senior members of the audit team are prevented from taking part in political activity on behalf of a political party, or special interest group, whose activities relate directly to the functions of local government or NHS bodies in general, or to a particular local government or NHS body; and
- the Appointed Auditor and members of the audit team must abide by the Commission's policy on gifts, hospitality and entertainment.

Responsibility in relation to fraud detection

Auditing standards require the auditor to undertake specific discussions with senior management within the group, including the Audit Committee.

On this page we summarise specific responsibilities in relation the fraud detection

The current economic environment has seen an increased risk of fraud as a result of increased pressure for companies to meet the expectations of stakeholders. Outlined below is a summary of the responsibilities of both KPMG and management with respect to fraud in the context of a year end audit.

Responsibilities

The primary responsibility for the prevention and detection of fraud and error rests with both management and those charged with the governance of an entity.

It is important that they place a strong emphasis on fraud prevention, which may reduce the opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment.

This involves creating and maintaining a culture of honesty and ethical behaviour and establishing appropriate controls to prevent, deter and detect fraud. When management and those charged with governance fulfil these responsibilities, the opportunities to commit fraud can be reduced significantly.

Responsibilities of management

It is the responsibility of management to establish a control environment and maintain policies and procedures to assist in achieving the objective of ensuring, as far as possible, the orderly and efficient conduct of the entity's business.

This includes responsibility for implementing and ensuring the continued operation of accounting and internal control systems which are designed to prevent and detect fraud and error. Such systems reduce, but do not eliminate, the risk of misstatements, whether caused by fraud or error.

Responsibilities of those charged with governance

It is the responsibility of those charged with governance to ensure, through oversight of management, the integrity of an entity's accounting and financial reporting systems and that appropriate controls are in place, including those for monitoring risk, financial control and compliance with the law.

Responsibilities of the auditor

The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework.

An audit conducted under The Code of Audit Practice and in accordance with International Standards on Auditing is designed to provide reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error.

The fact that an audit is carried out may act as a deterrent, but the auditor is not and cannot be held responsible for the prevention of fraud and error.

Fraud versus error

The term 'error' refers to an unintentional misstatement in the reporting of an entity.

The term 'fraud' refers to an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception or misconduct to obtain an unjust or illegal advantage.

There are two types of misstatements relevant to an auditor's consideration of fraud:

Misstatements resulting from fraudulent financial reporting, which involves intentional misstatements or omissions of amounts or disclosures in financial reporting to ultimately deceive financial statement users, and

Misstatements resulting from misappropriation of assets, which typically involve theft of an entity's assets and is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing.

Impact on the audit and use of resources assessment

We will undertake the following procedures again this year in respect of fraud:

- Make enquiries of management in connection with fraud
- Evaluate broad programmes and controls to prevent, deter and detect fraud
- Perform additional procedures to identify fraud risks
- Specific procedures are required to assess the risk of fraudulent revenue recognition and the risk of management override of controls through reviews of: journal entries; biased estimates; and significant unusual transactions
- Communicate our findings to management and those charged with governance