

# Annual Audit and Inspection Letter

## Transport for London

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<b>Reference:</b>	Final version
<b>Date:</b>	June 2006

## Executive Summary

### The purpose of this letter

This Annual Audit and Inspection Letter (AA&IL) is presented by TfL's Relationship Manager. The letter summarises the conclusions and significant issues arising from our audit and inspection work at TfL in the period since the 2003/04 Annual Audit Letter was presented.

Both the Audit Commission and KPMG LLP have issued separate reports during the year having completed specific aspects of the audit and inspection programme. These reports are listed at Appendix 1 for information.

Appendix 2 sets out the scope of audit and inspection.

Appendix 3 provides information about the fees charged.

## Key messages

### TfL's performance

The Initial Performance Assessment report published in November 2004 analysed TfL's overall performance and found it to be an 'excellent' organisation. The outcome was the highest of the five possible categories of poor, weak, fair, good, and excellent.

TfL was found to be doing well in the following areas:

- It has a good understanding of the problems affecting transport in London, and a clear and ambitious vision for how to deal with them
- It focuses on priorities such as improving London's bus service
- It has strong leadership and effective management, and was putting in place a wide range of improvement programmes

TfL had set itself the goal of improving yet further including:

- Improving services on the London Underground which it took over in 2003; and

- Working to bring the different parts of the organisation together.

The approach to improvement planning adopted by TfL has provided a firm basis for the organisation moving forward. It covers the main areas for improvement identified in the Initial Performance Assessment report.

On the whole realistic timescales have been set for the actions in the improvement plan. The majority of the targets set by TfL for 2005 have been achieved.

### The Accounts

TfL produced its financial statements well within the statutory deadline and KPMG LLP issued an unqualified audit opinion on those accounts on 12 August 2005, almost two months earlier than in the prior year.

### Financial position

TfL's financial position is soundly based. The organisation reported general fund reserves of £150m, earmarked reserves of £973m and short term investments of £1,300m at 31 March 2005.

The ability of TfL to deliver a sustained programme of investment was further increased in July 2004 when the results of the Spending Review 2004 were announced. The agreement reached between the Secretary of State and TfL has provided a five-year financial framework for investment in London's transport infrastructure.

TfL has since raised additional funding through a bond issue of £200m in December 2004 to fund the significant number of projects identified in its business plan to enhance the transport infrastructure across London in line with its 5-Year Business Plan (2005/06-2009/10) and 5-Year Investment Programme which was presented to the Board in October 2004. The challenge for TfL going forward is to put in place the necessary governance arrangements to ensure the Investment Programme is delivered on time and within budget.

### Other governance arrangements

TfL's overall corporate governance arrangements are satisfactory in most key areas and have continued to develop through the year with the previously identified weakness being addressed. As indicated above, further work is needed to

develop and implement the processes through which the increasing level of capital investment will be monitored and controlled.

### Action needed by TfL

TfL needs to ensure that:

- The raising of any additional funding is matched in both timing and value to capital investment requirements to ensure that balances are kept at reasonable levels and that TfL does not suffer any unnecessary debt servicing charges.
- It develops and implements robust processes for monitoring and controlling its increased levels of capital investment.
- It continues to develop its approach to improvement planning and monitor progress.

## Introduction

### Background to audit & inspection programme

To ensure that organisations receive a tailored, seamless service, integrated with the work of other inspectorates, the Audit Commission has appointed a Relationship Manager for each audited body. The Relationship Manager is the Commission's primary point of contact with you and is also the interface between the Commission and the other inspectorates, Government Office and other key stakeholders.

### Objectives of audit & inspection

**Audit** – KPMG's main objective as your appointed auditor is to plan and carry out an audit that meets the requirements of the Code of Audit Practice. This includes a risk-based approach to planning the audit, and undertaking work focussing on your significant financial and operational risks that are relevant to their audit responsibilities.

Central to the audit are your corporate governance arrangements. The audit is then structured around the three elements of our responsibilities as set out in the Code and shown in Appendix 2.

**Inspection** - Inspection work is based around section 10 of the Local Government Act 1999, which requires the Audit Commission, as your inspectors, to carry out inspections and deliver reports that will:

- Enable TfL and the public to judge whether best value is being delivered.
- Enable TfL to assess how well it is doing.
- Enable the Government to assess how well its policies are being implemented.
- Identify failing services where remedial action may be necessary.

## TfL's Performance

*TfL has approached improvement planning in a comprehensive, clear and methodical manner. A high level improvement plan has been produced that addresses the areas for improvement*

*identified in the Initial Performance Assessment report.*

### Improvement planning

The improvement areas are categorised under the appropriate headings of:

- Partnership working and shared priorities
- Achieving the benefits of 'one TfL'
- Service quality improvements
- Challenge through scrutiny, transparency and learning
- Reducing travel and Public Private Partnership issues

Under each of these headings the areas for improvement are clearly identified as are the management response, the responsible manager, key dates and what action has, or is being carried out. These amount to clear management actions, accountability and timescales.

As previously stated, this is a high level improvement plan. The detail that underpins this plan is contained in a range of other plans and strategies that are referenced in the improvement plan. Improvement planning is therefore integrated within TfL's strategic planning and budget setting process.

The achievement of the improvement plan is monitored by the Audit Committee. The plan is also regularly monitored by senior managers. Key elements of the plan are monitored by other parts of TfL. For example, 'lessons to be learnt' from VFM reviews in the context of the Investment Programme is co-ordinated by the 'Oversight Group' in the Commissioner's office.

The pan GLA group issues are being addressed appropriately by a range of mechanisms. For example, efficiency across the GLA group is being considered by the GLA/functional body performance improvement network.

The approach to improvement planning adopted by TfL is based on firm foundations.

### Implementation

The majority of the targets set by TfL for achievement during 2005 have been achieved. In the context of the limited amount of time since the Initial Performance Assessment was published (November 2004); this indicates that, on the whole, realistic targets have been set. Targets appropriately reflect the fact that the benefits of the improvements will mainly be achieved in the medium to long term.

*Partnership working and shared priorities*

There is strong evidence of improved engagement with stakeholders, in particular London Boroughs, in the last year. Changes in the business planning process for 2006/07, indicate a high level of commitment to improve relationships with key stakeholders.

*Achieving the benefits of 'one TfL'*

Good progress has been made in the areas under this heading, in particular in developing the organisation's procurement capacity. However, an over-ambitious target was set for the revision of human resource and equalities policies. The adjusted target reflects a more realistic, but still challenging, approach.

Challenging targets have also been set in the key areas of efficiency, demonstrating delivery of vfm and establishing a pan-TfL performance appraisal system.

*Service quality improvements*

The five year investment programme includes projects covering important service areas, such as capacity of the transport systems, customer care standards, accessibility and environmental quality. Progress has been made on developing project management controls that will underpin the effective delivery of these projects.

*Challenge through scrutiny, transparency and learning*

The areas covered under this heading are relevant to the GLA and all its functional bodies. Accordingly, the GLA is leading a review 'Delivering Better Services to Londoners' that has identified five key areas for improvement. The outputs from the review will determine the speed at which the improvements can be made.

Good progress has been made in those areas that are under the control of TfL. For example, an initial review has been carried out of how TfL can capture and share learning within the organisation. Contacts with other organisations, such as Passenger Transport Executives and academic institutions, have been strengthened in order to learn from other bodies.

*Reducing travel demand and Public Private Partnership issues*

Again, good progress has been made in the areas under this heading. For example, TfL is working closely with the GLA on the use of the planning system to reduce demand for travel.

Work is currently in progress to develop a Travel Demand Management Strategy across TfL. Arrangements have been put in place to ensure that the benefits of Public Private Partnership are achieved through the five year investment programme.

## Performance Information

### Best Value Performance Plan

KPMG LLP have a statutory duty to audit TfL's BVPP to ensure that it fully complies with ODPM guidance. The audit of TfL's BVPP is almost complete and the formal report on the BVPP will be issued separately during October 2005.

As in previous years, we expect the formal report to provide an unqualified opinion on the BVPP and not to recommend an inspection by the Audit Commission or a direction by the Secretary of State.

### Best Value Performance Indicators

KPMG LLP have a statutory duty to audit TfL's BVPIs. This requires an assessment of the adequacy of the systems that TfL has in place to collect and record specified performance information for publication in its BVPP.

The resulting opinion on TfL's systems for collecting and publishing the Audit Commission's BVPIs is due to be issued in October 2005 and at this stage we envisage concluding that TfL has adequate systems in place to produce the required BVPIs. We can also confirm that improvement since last year will mean that we will not be issuing reservations as to the compilation of the figures although the audit has identified the need for a number of indicators to be amended.

## Accounts and Governance

*KPMG LLP have given your accounts an unqualified audit opinion.*

*Your overall corporate governance arrangements are satisfactory although management need to develop and implement processes to monitor*

*and control the delivery of the Investment Programme.*

## Audit of 2004-05 accounts

KPMG LLP gave an unqualified opinion on TfL's accounts on the 12 August 2005.

The accounts were certified almost two months earlier than in the previous year. This performance reflects well on the Financial Reporting Team and the teams within the modes given that the accounts had to reflect the requirements of the new CIPFA SORP and thus required a wholesale restatement of prior year figures to meet the revised group accounting requirements placed on TfL.

Our audit work identified the need for a number of amendments and some disclosure and presentational issues in the draft accounts which were discussed with officers, highlighted to the Audit Committee in June and resolved prior to the audit opinion being issued.

Looking forward to next year, the Accounts & Audit Regulations require the approval of the accounts by the Board and also publication a month earlier than for 2004/05, that is by 30 June 2006 and 30 September 2006 respectively.

Based on the performance this year, TfL should be in a good position to achieve the requirement to bring approval and publication forward by a further month for the 2005/06 annual accounts.

## Financial standing

*TfL's financial position is soundly based. The organisation reported general fund reserves of £150m, earmarked reserves of £973m and short term investments of £1,300m at 31 March 2005.*

### Level of Reserves

TfL has built up significant levels of reserves since it was created in July 2000. The Corporation reported a surplus for the year of £24.5m after the transfer of almost £540m to earmarked reserves and the funding of subsidiaries of £1,263m. TfL reported total reserves, the majority of which are capital (including earmarked reserves) of £1,123m and short-term investments of £1,300m at 31 March 2005. This compares with the total to be financed from government grants and local taxation of £2,135m in 2004-05.

As indicated previously, TfL has a significant capital investment programme aligned to its business plan and has assessed the associated funding requirements. Given the proposed investment programme it will be important for TfL to ensure that it has the physical capacity to deliver the proposed programme and to maintain its reserves at reasonable levels in the short to medium term.

## Systems of internal financial control

*KPMG LLP have not identified any significant weaknesses in the overall control framework.*

Our audit work on the key financial systems resulted in 15 performance improvement observations, none of which were high priority in terms of action required.

### Internal Audit

As part of our audit work we seek to rely, wherever possible, on the work undertaken by internal audit. As in previous years, we have been able to conclude that internal audit provides an effective service overall and its work in support of the Corporate Governance Assurance Statement is in line with best practice.

Where Internal Audit have tested the design and operation of systems of internal financial control we have been able to place reliance on their work.

## Standards of financial conduct and the prevention and detection of fraud and corruption

*We have not identified any significant weaknesses in your arrangements to prevent and detect fraud and corruption.*

## Legality of transactions

*We have not identified any significant weaknesses in the framework established by TfL for ensuring the legality of its significant financial transactions.*

Our work at TfL to review the arrangements in place for ensuring the legality of transactions with a financial consequence consisted of:

- Reviewing Board and Committee minutes;
- Discussions with senior officers on a range of issues;
- Obtaining specific legality representations on the year end accounts;
- Investigation of concerns raised with us by electors or other interested parties.

We are pleased to note that TfL has continued to operate generally robust arrangements in this area in the past year.

## Other work

### Grant Claims

As the appointed auditors to TfL, KPMG LLP are required to certify any grant claims submitted by the organisation. As a single purpose organisation TfL has tended to only submit one or two claims per annum for audit purposes. We are however pleased to report that previous identified weaknesses in the compilation of claims have been addressed prior to our most recent audit.

### National Fraud Initiative

TfL took part in the Audit Commission's national fraud initiative (NFI) in 2003/04. The NFI, which is undertaken every two years, brings together data from local authorities, NHS bodies, government departments and other agencies, to detect a wide range of frauds against the public sector.

The exercise identified a small number of issues which have been reported to the Audit Committee by the Director of Audit and we are satisfied that appropriate processes are in place for the investigation and reporting of potential cases of fraud under the NFI.

### Review of resilience

In line with its audit risk assessment KPMG LLP have recently conducted a review of TfL's arrangements in respect of resilience. The review has utilised much of the best practice identified by the Audit Commission in its work with the London Resilience Forum. The results of the review are currently being discussed with staff in TfL and the full report will be presented to a future meeting of the Safety, Health and Environment Committee (SHEC).

## Looking Forwards

### Future audit and inspection work

We have an indicative plan for 2005/06 which was approved by the Audit Committee in March 2005. Our planned work, together with that of other inspectorates, is included on both the Audit Commission and LSIF (Local Services Inspectorates Forum) websites.

We have sought to ensure, wherever possible, that our work relates to the improvement priorities of TfL. We will continue with this approach when planning our programme of work for 2006/07.

### Revisiting the IPA

The main part of our work programme for next year will focus on tailoring the use of resources (including the value for money assessment) and the direction of travel methodologies to ensure that they are fit for purpose for TfL. This will be done in co-operation with the other bodies in the GLA Group.

We will use the agreed methodologies to assess TfL's use of resources and direction of travel next year.

We will also begin to engage with the GLA Group on the timing and methodology for the next detailed performance assessment mechanism.

## Closing remarks

This letter has been discussed and agreed with key personnel within TfL. A copy of the letter will be presented at the Audit Committee on 5 October 2005.

TfL has taken a positive and constructive approach to our audit and inspection and we would like to take this opportunity to express our appreciation for TfL's assistance and co-operation.

## Availability of this letter

This letter will be published on the Audit Commission's website at [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk), and also on TfL's website.

**Ken Davis**  
**Relationship Manager**

**Date 27 September 2005**

## Status of our reports to Transport for London

Our annual audit and inspection letter is prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission. Annual audit and inspection letters are prepared by relationship managers and appointed auditors and addressed to members and officers. They are prepared for the sole use of the audited and inspected body, and no responsibility is taken by the Audit Commission or its appointed auditors to any member or officer in their individual capacity, or to any third party.

## Audit & Inspection reports issued

Indicative Audit Plan	March 2004
Interim Report	April 2005
Highlights Memorandum	June 2005

## Scope of audit and inspection

### Audit

Our main objective as your appointed auditor is to plan and carry out an audit that meets the requirements of the Code of Audit Practice. We adopt a risk-based approach to planning our audit, and our audit work has focused on your significant financial and operational risks that are relevant to our audit responsibilities.

Central to our audit are your corporate governance arrangements. Our audit is then structured around the three elements of our responsibilities as set out in the Code and shown in Exhibit 1.

#### The three main elements of our audit objectives



#### Accounts

- Opinion.

#### Financial aspects of corporate governance

- Financial standing.
- Systems of internal financial control.
- Standards of financial conduct & the prevention and detection of fraud and corruption.
- Legality of transactions.

#### Performance management

- Use of resources.
- Performance information.
- Best Value Performance Plan.

## Inspection

Inspection work is based around section 10 of the Local Government Act 1999, which requires us to carry out inspections and deliver reports that will:

- Enable TfL and the public to judge whether best value is being delivered;
- Enable TfL to assess how well it is doing;
- Enable the Government to assess how well its policies are being implemented; and
- Identify failing services where remedial action may be necessary.

The Audit Commission has circulated to all audited bodies a statement that summarises the key responsibilities of auditors. Our audit has been conducted in accordance with the principles set out in that statement. What we say about the results of our audit should be viewed in the context of that more formal background.

## Audit and Inspection fee

### Audit fee update

Audit area	Plan 2004/05	Actual 2004/05
Accounts	293,500	293,500
Use of Resources	40,000	40,000
Performance/Mandated Work	50,000	50,000
TOTAL CODE OF AUDIT PRACTICE FEE	383,500	383,500

### Inspection fee update

The full year inspection fee is £17,500. The actual fee for 2004/05 will be in line with that planned.