

Date: 7 December 2012

Item 9: KPMG Review of Internal Audit Effectiveness

This paper will be considered in public

1 Summary

- 1.1 The purpose of this paper is to present to the Audit and Assurance Committee KPMG's report setting out the findings from their review of Internal Audit effectiveness.

2 Recommendation

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

3 Background

- 3.1 KPMG have carried out their review of TfL Internal Audit in accordance with the agreed Terms of Reference that were presented to the Audit and Assurance Committee at its meeting on 15 June 2012. A copy of KPMG's report is included as Appendix 1.
- 3.2 The report finds that Internal Audit's methodologies and day to day processes are generally effective and comments positively on our 'direction of travel' with regard to the integrated assurance agenda. The report also sets out a number of areas for further development, some of which were already being progressed.
- 3.3 Overall, we agree with KPMG's recommendations. The next step will be to develop a detailed action plan for taking forward these recommendations. The action plan will be presented to the next meeting of the Audit and Assurance Committee.

List of appendices to this report:

Appendix 1 – KPMG Review of TfL Internal Audit.

List of Background Papers:

None.

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Review of Internal Audit

Transport for London

14 November 2012

Review of internal audit

Important notice

This Report has been prepared on the basis set out in our Engagement Letter addressed to the General Counsel of Transport for London (“the Client”) dated 15 June 2012 and should be read in conjunction with the Engagement Letter.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the Engagement Letter.

This Report is for the benefit of only the Client. This Report has not been designed to be of benefit to anyone except the Client. In preparing this Report we have not taken into account the interests, needs or circumstances of anyone apart from the Client, even though we may have been aware that others might read this Report. We have prepared this Report for the benefit of the Client alone.

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Attention is drawn to the limitations in the scope of our work and Report. This engagement is not an assurance engagement conducted in accordance with any generally accepted assurance standards and consequently no assurance opinion is expressed. In preparing our report, our primary source has been review of supporting documentation and representations made to us by management. We do not accept responsibility for such information which remains the responsibility of management.

Responsibility for the establishment, maintenance and operation of internal audit and assurance processes adequate for TfL’s needs remains at all times with management. Management also have final responsibility for determining the significance of matters of concern noted in this report, for evaluating the observations and recommendations that have arisen from our work and for implementing and monitoring corrective action. Transport for London Management have reviewed this report for factual accuracy and accept the content and recommendations.

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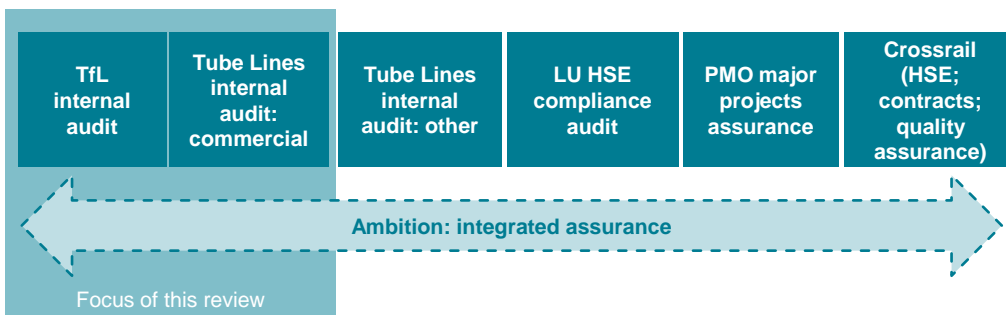
Executive summary

Purpose and scope of review

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

As required by the agreed scope of work, this review has focused on the TfL internal audit function and the commercial audit work at Tube Lines and has not covered other assurance providers in detail, although we have held meetings with some stakeholders overseeing other assurance functions, particularly with regard to understanding the integrated assurance position.

The scope of this review was agreed with the Director of Internal Audit, the Chief Finance Officer, General Counsel and the Chair of the TfL Audit and Assurance Committee.



Background

The TfL internal audit function has seen significant changes over the past two years. Following a strategic review of the assurance arrangements in place as part of Project Horizon, resources were reconfigured resulting in a 25% reduction in the direct staff budget of the internal audit function. The most significant area of change was a reduction in the volume of audit work on major projects, in recognition of the investment programme assurance role of the PMO. TfL is also moving towards better aligning assurance sources, and an integrated assurance plan for 2012/13, incorporating the work of Internal Audit

and other assurance providers, was presented to the Audit Committee (now the Audit and Assurance Committee) for approval in March 2012.

The London Underground HSE function will transfer into the TfL Internal Audit team later in the year, giving rise to further opportunities for more integrated assurance. In the longer term it may be beneficial to consider similarly integrating the Tube Lines function.

Approach

Our approach in delivering this review has consisted of:

- interviews with stakeholders, including assurance providers, senior officers who rely on internal audit, and the Chair of the Audit and Assurance Committee. A full list of interviewees is provided at [Appendix Three](#).
- review of relevant documentation to gain an understanding of how the internal audit function operates, including a review of a sample of internal audit files to assess the internal file review process and draw our own conclusions on the quality of documentation including a review of a sample of internal audit files to assess the internal file review.

Throughout the review we have used as our reference point the K'SPRInt (KPMG Strategic Performance Review of Internal Audit) methodology for undertaking reviews of Internal Audit functions. The approach is underpinned by IIA standards and breaks down points for consideration into three main areas: *positioning, people and processes*. Full details of this approach are included in [Appendix Two](#).

Our analysis is based partly on evidential findings and partly on perceptions gleaned from interviews, and we have stated clearly throughout on what basis our conclusions are formed. Where perceptions have been stated, these are based on the majority of interviewees with whom the topic was discussed holding such as view.

Review of internal audit

Executive summary (cont.)

Summary of findings

We set out here a summary of our findings, providing commentary on the areas of good practice or recent improvement we have noted followed by areas for development.

Areas of good practice or recent improvement

- ✓ The integrated assurance agenda has been driven forward over the past year under the guidance of the Assurance Delivery Group. An Integrated Assurance audit plan was developed for the first time for the 2012/13 period, and we have seen evidence of improved joint working between assurance functions to share resources and findings, and minimise duplication of effort. Stakeholders have provided positive feedback regarding improvements in joint working and reduction in duplication of assurance. The Audit and Assurance Committee now has an enhanced overview of sources of assurance across the business.
- ✓ The TfL internal audit function has sufficient resources, which allows flexibility in the prioritisation or timings of reviews, allowing the function to better meet the needs of stakeholders.
- ✓ Our review of internal audit's methodology and key documents, including review scopes, audit programmes and reports demonstrated that the majority of day-to-day processes within the department are working effectively. For example, the audit planning cycle continues to improve, driven by internal audit and the ADG, to ensure consultation with stakeholders, and reports are concise and have an overall defined assurance rating.
- ✓ Internal audit evaluate themselves against Institute of Internal Auditors (IIA) standards, and have clearly set out where action is required to develop processes where standards have not been fully met. This periodic process, supplemented by external reviews such as this, helps to ensure that the function remains compliant with guidelines and that remedial action is taken where necessary.

In terms of areas for development, we have identified areas which require consideration by TfL management and the ADG and areas which internal audit can address on their own.

Areas for development by TfL management

- **Mapping assurances:** TfL recognises that there is further room for development with integrated assurance, and work is currently underway to map controls to risks in certain parts of the business, with the aim of building an integrated assurance plan around this (**see recommendation one**). We note however that enhancing strategic risk management is an important prerequisite to formulating a robust integrated assurance plan, as assurance functions must be employed where they are most needed, i.e. to provide assurance over controls mitigating the greatest risks to the organisation.
- **Define the future of the integrated assurance ambition:** Post-Project Horizon, the organisation and its assurance arrangements continue to evolve. The forthcoming transition of the LU HSE assurance function to the TfL IA team, the development of the TfL management system and associated in-built self-assurance, and the development of strategic risk management mean that the internal audit and assurance functions will need to continue to adapt to provide the most appropriate assurance offer to the business. The Assurance Delivery Group (ADG) has made significant progress in moving forward the integrated assurance agenda, but now needs a formalised work programme to set out clearly its next steps. (**see recommendation three**).

We also note, from discussion with stakeholders, that although operational risk is seen to be managed effectively at TfL, strategic risk management is still maturing. This is constraining the ability to develop assurance plans that are genuinely risk-based. Risk management is beyond the scope of this review and we will therefore not raise a recommendation. We note however that the identification and management of strategic risks should become more robust as the organisation's strategic aims and objectives become more formalised.

Review of internal audit

Executive summary (cont.)

Areas for development by internal audit

- **Medium-term assurance strategy and indicative plan:** enhanced consideration of strategic risk would facilitate the production of a medium term internal audit strategy, which would be used to drive the currently produced annual plan. This in turn would allow a longer term, but flexible view of how assurance is provided against the organisation's key risks, and would link with integrated assurance in determining the levels and sources of assurance year on year. This will help assurance providers, management and the Audit and Assurance Committee identify and challenge any gaps or apparent over-auditing. For example, TfL may deem it appropriate to engage internal audit to review a system every three years, with limited assurance in the interim gained through a self assessment mechanism (see recommendation eight). This approach is likely to evolve as a new performance system is rolled out across the business and self-assurance becomes a greater part of the wider assurance framework. It's success will also be contingent on enhancements to risk management, as described above.
- **Integrated assurance reporting:** as integrated assurance develops further, the internal audit function must determine how it will report against the integrated plan (see recommendation two) and the extent to which outputs from other assurance functions will be sense checked by the Director of Internal Audit and standardised.
- **Evaluating the performance of internal audit:** internal audit are currently developing a framework for evaluating their performance on an ongoing basis. We note that this is intended primarily for use within the department rather than the wider organisation, and recommend that the Audit and Assurance Committee provide input to this evaluation process, and monitor performance against agreed elements of the framework going forward. The evaluation criteria should be based upon internal audit's mission and objectives, and the organisation's view of the type of internal audit function needed, particularly in the context of the various services provided (see recommendation ten).

- **Linking audit procedures to risk:** our review of a sample of audit files found that due process is generally being followed, but that audit programmes and scopes need to be more clearly linked to specific risks identified (see recommendation nine).
- **Clarifying positive assurances in individual reports:** individual review reports could be enhanced by stating clearly the risks reviewed and work performed to assess the related controls, to allow users to determine where positive assurance has been attained as well as the areas for development (see recommendation twelve).

We have raised 13 recommendations as a result of this work.

	Priority one	Priority two	Priority Three	Total
Raised	-	6	7	13
Agreed	-	6	7	13

The remainder of this report is structured around our methodology for reviewing internal audit effectiveness, which considers:

- **Section One:** the positioning of internal audit within the organisation
- **Section Two:** people; and
- **Section Three:** internal audit processes.

Further details on this approach are provided in [Appendix Two](#).

Review of internal audit

Section One: findings – positioning

Introduction

This sections sets out our findings in relation to the positioning of internal audit within the wider organisation. We have presented commentary against the five sub-headings shown in Appendix 2, with recommendations displayed where areas for development have been identified.

The colour in the right hand column represents the RAG rating assigned to each recommendation.

Recommendation rating	Meaning
Priority One	A significant weakness in the system or process which is putting you at serious risk of not achieving your strategic aims and objectives. In particular: significant adverse impact on reputation; non-compliance with key statutory requirements; or substantially raising the likelihood that any of your strategic risks will occur. Any recommendations in this category would require immediate attention.
Priority Two	A potentially significant or medium level weakness in the system or process which could put you at risk of not achieving your strategic aims and objectives. In particular, having the potential for adverse impact on your reputation or for raising the likelihood of your strategic risks occurring.
Priority Three	Recommendations which could improve the efficiency and/or effectiveness of the system or process but which are not vital to achieving your strategic aims and objectives. These are generally issues of good practice that the auditors consider would achieve better outcomes.

Review of internal audit

Section One: findings – positioning

Core indicator	Strengths	Areas for development
<p>Drivers and mission</p> <p><i>The drivers for internal audit are aligned with corporate goals and the needs of key stakeholders. The mission and role are formally defined within a wider corporate governance framework and have been effectively communicated</i></p>	<ul style="list-style-type: none"> ✓ The mission of internal audit is clearly set out in the Internal Audit Charter. The Charter was developed in conjunction with senior audit managers and other members of the internal audit team, ensuring a good level of engagement and awareness of the document. It has been approved by the Audit and Assurance Committee. ✓ TfL has an ambition to integrate its sources of assurance to provide an overall view of how its risks are being addressed. An Integrated Assurance audit plan was developed for the first time for the 2012/13 period, and we have seen evidence of improved joint working between assurance functions to share resources and review findings, and minimise duplication of effort. Stakeholder feedback has been positive in relation to this increase in collaborative working. ✓ The Assurance Delivery Group (ADG) has been tasked with driving forward the integrated assurance agenda and has been involved in creating this first integrated plan and developing it further. The group incorporates stakeholders from different areas of the business, including finance directors, General Counsel, and assurance heads from Tube Lines, LU and Project Assurance. 	<p>Recommendation one: Assurance mapping</p> <p>The current audit plan is set out in the integrated assurance plan which amalgamates various source of assurance but does not clearly demonstrate the synergies and potential efficiencies to be gained from integrating assurance. Work is currently underway to map controls to risks, starting with HR and IM, with the aim of building an integrated assurance plan around this.</p> <p><i>We recommend that this process continues to be rolled out to all functions to allow an organisational map of risks, controls and assurances to be created, around which an integrated assurance plan can be constructed. [Responsibility: TfL Management, led by the Director of Internal Audit]</i></p> <hr/> <p>Recommendation two: Integrated assurance reporting</p> <p>Reporting of progress against the integrated assurance plan is a work in progress. Currently the Director of IA reports to the Audit and Assurance Committee quarterly summarising internal audit activity and, separately, provides commentary on the activity of other assurance providers. There is no currently no mechanism to summarise concisely and in a consistent format the assurances from work performed in the last quarter or to explicitly link those assurances back to risks being mitigated by the processes and controls subject to review.</p> <p><i>As integrated assurance develops further, the internal audit function should determine how it will report against the integrated plan and the extent to which outputs from other assurance functions will be sense checked and summarised by the Director of Internal Audit before inclusion in the report (and use in the annual internal audit opinion). [Responsibility: Director of Internal Audit]</i></p>

Review of internal audit

Section One: findings – positioning (cont.)

Core indicator	Strengths	Areas for development
<p>Drivers and mission <i>(continued)</i></p>		<p>Recommendation three: ADG work programme</p> <p>Post-Project Horizon, the organisation and its assurance arrangements continue to evolve. The forthcoming transition of the LU HSE assurance function to the TfL IA team, the development of the TfL management system and associated in-built self-assurance, and the development of strategic risk management mean that the internal audit and assurance functions will need to continue to adapt to provide the most appropriate assurance offer to the business.</p> <p><i>The Assurance Delivery Group (ADG) has made significant steps in moving forward the integrated assurance agenda, but now needs a formalised work programme to set out clearly its next steps. This should include actions and milestones to achieve these.</i> [Responsibility: TfL Management and Director of Internal Audit]</p>
<p>Customers and services <i>Internal Audit customers and services have been formally established to address the needs of the business</i></p>	<ul style="list-style-type: none"> ✓ Internal audit have begun to perform consultancy services to accompany its more traditional system audits and fraud work. This promotes more cooperative working between internal audit and management, and involvement of internal audit in the early stages of projects to help ensure they are set up and managed effectively. We note that some stakeholders have actively requested consultancy support, demonstrating its perceived value to the business. ✓ Feedback is sought from internal audit's customers, with collated results reported to the Audit and Assurance Committee on a quarterly basis. Results from 2011/12 were positive, with the vast majority of respondents agreeing or strongly agreeing to the questions posed, including IA's understanding of issues and timely reporting. 	<p>Recommendation four: Impact of recommendations</p> <p>A number of interviewees expressed concern around the ability of IA to add real value by getting to the root of the problem and raising useful recommendations. The perception of several stakeholders is that issues are not always clear in terms of their strategic impact on the organisation.</p> <p><i>Recommendations included in reports should clearly demonstrate the impact of non-implementation on the business and therefore the value that implementation will add.</i> [Responsibility: Director of Internal Audit]</p>

Review of internal audit

Section One: findings – positioning (cont.)

Core indicator	Strengths	Areas for development
<p>Relationship management</p> <p><i>Internal Audit maintains effective relationships with key stakeholders.</i></p>	<ul style="list-style-type: none"> ✓ IA are aware of their key stakeholders. This includes the General Counsel, Audit and Assurance Committee (including the Chair separately), and Directors and managers from around the organisation. ✓ Feedback received from stakeholders interviewed was positive in regards to relationships with internal audit. Senior officers and review leads are engaged in the annual planning cycle and at the appropriate stages for individual reviews. This ensures that reviews are more likely to meet the needs of stakeholders. 	<p>Recommendation five: Frequency of meetings</p> <p>Two stakeholders interviewed commented that meetings with internal audit were too frequent, and that agenda content was therefore not always sufficient.</p> <p><i>Internal audit should aim to build its schedule of stakeholder meetings around the integrated assurance plan and emerging risks to ensure there is a clear need and focus for each meeting held. [Responsibility: Director of Internal Audit]</i></p>
<p>Organisation and structure</p> <p><i>The structure of Internal Audit promotes objectivity and consistency.</i></p>	<ul style="list-style-type: none"> ✓ The Director of Internal Audit reports to the General Counsel, but also has direct access to the Audit and Assurance Committee, with annual meetings held without the presence of management, helping to ensure independence of the function. ✓ Internal Audit receives its mandate from the Audit and Assurance Committee, and the committee approves the annual IA plan. IA provides quarterly reports to the committee summarising the findings of all reports issued, and the Director of IA attends all meetings to present these. ✓ The Director of IA has a role to promote quality and consistency in work performed, which is carried out in part through his review of all reports before issue. Other assurance functions have separate ways of working, but we note that an exercise has recently been undertaken to compare working practices across functions and identify areas of good practice and development needs. This process will help to promote consistency across TfL's assurance providers. Improvement actions from this exercise have been clearly defined. 	

Review of internal audit

Section One: findings – positioning (cont.)

Core indicator	Strengths	Areas for development	
Organisation and structure <i>(cont.)</i>	✓ The Tube Lines commercial audit team reports to the Risk Management Group (RMG), chaired by the Director of Finance (Tube Lines). Tube Lines no longer has its own Audit Committee, but outputs from its work are reported to the TfL Director of Internal Audit, and through him to the TfL Audit and Assurance Committee.		

Review of internal audit

Section Two: findings – people

Introduction

This sections sets out our findings in relation to the ‘people’ aspect of our review, including reporting lines, competencies and staffing strategy.

Core indicator	Strengths	Areas for development
<p>Success criteria</p> <p><i>Success criteria for Internal Audit have been established. Internal Audit is evaluated against the criteria.</i></p>	<ul style="list-style-type: none"> ✓ Internal audit periodically evaluate themselves against Institute of Internal Auditors (IIA) standards, using an IIA tool for assessing quality. This enables a systematic comparison of the organisation, management and practice of internal audit to the mandatory aspects of the International Professional Practice Development Framework (IPPDF) of the Institute of Internal Auditors. ✓ The last evaluation was conducted in April 2012, and IA identified minor areas for development, for example updating the Audit Manual to reflect the consultancy service now offered. Action is now being taken to address development areas arising from this exercise. 	<p>IA have KPIs in place for timeliness of reporting and customer feedback. No others KPIs are currently reported but a framework for evaluating IA’s performance is currently being developed. We have considered this point in ‘processes – performance measurement later in this report.</p>
<p>Competencies</p> <p><i>Internal Audit core competencies are directly related to its mission, role, and scope of work.</i></p>	<ul style="list-style-type: none"> ✓ Following Project Horizon, IA was formed into 5 strands, incorporating various specialties. This has allowed staff to develop expertise in their fields. 	

Review of internal audit

Section Two: findings – people (cont.)

Core indicator	Strengths	Areas for development
<p>Staffing strategy</p> <p><i>Internal Audit's staffing strategy reflects its mission, role, and required core competencies. It is sufficiently flexible to respond to change in demand.</i></p>	<ul style="list-style-type: none"> ✓ Discussion with stakeholders has demonstrated that IA are generally considered to have the core competencies required to support the department's mission and audit plan. We note that difficulties have previously been encountered in recruiting sufficiently qualified staff in IM, but that the use of agency staff has been effective in providing a temporary solution. ✓ IA have demonstrated that they are able to be sufficiently flexible to accommodate additional work required in the year, or to provide ad hoc work. Adjustments to the audit plan are approved by the Audit and Assurance Committee. ✓ Staff have been seconded from other parts of the business previously to fill resource gaps temporarily, for example during the NFI exercises. Staff can also be seconded out to other departments or other audit functions. Not only does this model maximise flexibility of resources, it also promotes a good balance of continuity through permanent staff with innovation from secondees. 	<p>Recommendation six: Defining competencies</p> <p>IA have not formally defined the overall mix of competencies required within the department. This creates the risk that there is no clear basis for recruitment decisions or responding to changes in demand from the business.</p> <p><i>A matrix of required competencies should be developed based on the current needs of the business and IA's mission and role. It should define the optimum skill mix and be sufficiently flexible to respond to changes in demand. Such a document is particularly important given the structure of the TfL IA function, as specialisation of staff reduces the flexibility of resources to fill gaps. [Responsibility: Director of Internal Audit]</i></p>

Review of internal audit

Section Two: findings – people (cont.)

Core indicator	Strengths	Areas for development
<p>Career progression and development</p> <p><i>Internal Audit has an established career progression program that incorporates training and competency development.</i></p>	<ul style="list-style-type: none"> ✓ Although a formal training and development program is not in place, Senior Audit Managers and the Director of IA ensure that training opportunities are provided to staff to facilitate their professional development. ✓ The function takes on a number of non-auditors and provides them with training early on to obtain IIA certification, and further qualifications as their career progresses. ✓ A training budget exists for the function, which is overseen by the Director of IA. Training is available for soft skills (including report writing and managing performance) as well as technical areas. ✓ There are examples of effective secondments into the wider business, and of placements being provided within the department for Graduate Finance trainees working towards CIPFA or CIMA qualifications. 	<p>Recommendation seven: Rotation programme</p> <p>There has been low staff turnover in IA recently, which can reduce opportunities for innovation and challenge to existing staff practices.</p> <p><i>IA could consider expanding the existing secondment programme to increase exposure of staff in the wider organisation to internal audit, and vice versa. There may also be possibilities for secondments within the GLA family.</i> <i>[Responsibility: Director of Internal Audit]</i></p>
<p>Culture</p> <p><i>Internal Audit operates in a culture that fosters the well being of employees and achievement of its mission.</i></p>	<ul style="list-style-type: none"> ✓ Our interviews and review of documentation have not identified any areas for concern regarding the culture of internal audit, and we are not aware of any factors that may be indicative of a negative culture such as high turnover or levels of staff sickness. 	
<p>Appraisal</p> <p><i>Goals, aligned to functional objectives, are set each year for team members, who are subsequently appraised against these goals.</i></p>	<ul style="list-style-type: none"> ✓ The performance management process used within IA is consistent with that used across the organisation. As a result, we have not considered appraisal processes in detail. We note that individuals' goals are aligned to business priorities and that performance is monitored by line managers as required. 	

Review of internal audit

Section Three: findings – processes

Introduction

This sections sets out our findings in relation to internal audit processes, including the way in which reviews are planned, delivered and reporting upon.

Core indicator	Strengths	Areas for development
<p>Planning and delivery</p> <p><i>Internal Audit implements a good planning methodology and delivers high quality service.</i></p>	<ul style="list-style-type: none"> ✓ The annual planning process generally starts in October each year. Last year for the first time a more integrated approach to planning was undertaken, involving HSE as well as representatives from London Underground and Surface Transport. This has helped to reduce duplication and share best practice. ✓ Directorate level risk registers are the starting point for planning, and a workshop is held with directors and managers to discuss audit planning. This is supplemented by one-to-one meetings held between Senior Audit Managers and senior officers, to better understand issues and risks in different parts of the business. An iterative process then ensues, whereby plans are amended and agreed with stakeholders to arrive at a draft to be approved by the Audit and Assurance Committee. ✓ The annual plan is kept under review during the year and changes are made as necessary to reflect the changing demands of the business. ✓ Scopes for each review are prepared and approved within the IA team, and then discussed with the relevant officer in the organisation. An iterative process then ensures that the final scope reflects the needs of the business. 	<p>Recommendation eight: Medium term strategy</p> <p>Internal audit does not currently prepare a medium term strategy, and has only an activity plan covering the year ahead. Though it would require review and refresh at least annually as part of the planning cycle, such a strategy would enable IA and the Audit and Assurance Committee to understand how assurance is proposed to be gained over the longer term, and allow review and challenge to the coverage and frequency of reviews on a medium term programme. For example, it is extremely difficult to judge the prioritisation and time criticality of reviews in the absence of any information on frequency of review.</p> <p><i>The annual integrated assurance plan should be set in the context of a medium term strategy which incorporates inputs from all assurance functions to prevent duplication of effort. The strategy would make it clear which reviews required completing on a cyclical basis and enable review and challenge to be made to gaps, coverage and prioritisation in the context of a 3 – 5 year programme of activity. The plan should be explicitly linked to risks. [Responsibility: Director of Internal Audit]</i></p>

Review of internal audit

Section Three: findings – processes (cont.)

Core indicator	Strengths	Areas for development
<p>Planning and delivery <i>(continued)</i></p>	<ul style="list-style-type: none"> ✓ The Audit Manual formally sets out how reviews should be conducted, helping to ensure consistency and quality. The document has been mapped to key IIA standard to ensure compliance with internationally recognised practices. ✓ Recommendations are discussed with the auditee prior to approval of the report, ensuring that the final actions can be agreed. We have heard consistent reports from stakeholders that the recommendation follow-up process is working effectively. 	<p>Strategic risk management</p> <p>We expect to see any assurance function using the strategic risk register to drive the medium and short term plans of work, to ensure that reviews are focused on the key risks to an organisation achieving its strategic objectives. The strategic risk register would in turn be driven by objectives determined from the organisation's strategy.</p> <p>From discussion with stakeholders we have established that the communication of strategic objectives and the process of strategic risk management is still maturing at TfL. Exercises to refresh strategic risks tend to be isolated events and strategic risk management is not perceived to be fully embedded within the organisation. This lack of clearly defined risk at the highest level has therefore limited the extent to which the integrated assurance ambition and internal audit plan can be genuinely risk-focused.</p> <p>We have not raised a recommendation in relation to risk management as this is beyond the scope of our review. However, we draw management's attention to the limitations this places on the ability to develop a risk-based internal audit plan. We have outlined in Appendix One how we would expect to see integrated assurance being driven by strategic risks in due course.</p>

Review of internal audit

Section Three: findings – processes (cont.)

Core indicator	Strengths	Areas for development
<p><i>Planning and delivery</i> <i>(continued)</i></p>		<p>Recommendation nine: Risk-based procedures</p> <p>In one instance from our file review (review of supplier relationship management), there was no discussion of risk in the audit program, and it was therefore unclear how the set of procedures had been developed to respond to the organisation's risks.</p> <p><i>Risks identified in the scoping document (see recommendation above) should map directly through to the audit programme, with designed procedures in turn being mapped to these risks. This should result in more focused testing and a clearer link between perceived risk, procedures performed and days allocated. [Responsibility: Director of Internal Audit]</i></p>

Review of internal audit

Section Three: findings – processes (cont.)

Core indicator	Strengths	Areas for development
<p>Technology</p> <p><i>Internal Audit applies technology appropriately to support service delivery.</i></p>	<ul style="list-style-type: none"> ✓ All audit work, from the planning stage to final report, is documented in Auto Audit. This software allows budgeted and actual time allocations to be captured and incorporates all correspondence with stakeholders, audit documentation and report version control. It also contains an audit trail evidencing manager review of working papers. ✓ A function in this software allows issues documented during fieldwork to be automatically repopulated into reports, ensuring that issues identified are not omitted. ✓ Other use of technology includes 'Recommend', which records all actions raised in a database and allows tracking of implementation, 'IDEA', which is used for sampling and analytical work, and Webex, for seminars (e.g. by the IIA) and demonstrations of tools available. 	
<p>Performance measurement</p> <p><i>Internal Audit has an appropriate framework to measure its performance.</i></p>	<ul style="list-style-type: none"> ✓ As part of the performance management process, staff record annual objectives that are aligned with IA's goals. Several standard objectives that are used by the IA function (such as meeting budget, quality of work, compliance with manual) are incorporated into individual objectives. ✓ As noted earlier, IA collect feedback from auditees, and use this as a measure of success, along with completion of the annual plan within the required timescales. ✓ Every year a sample of audit files is selected for a quality review process undertaken by Senior Audit Managers. A checklist, based on key requirements of the Audit Manual and IIA checklist, is completed for each file, with results collated and disseminated to staff in team meetings. 	<p>Recommendation ten: key performance indicators (KPIs)</p> <p>IA have KPIs in place for timeliness of reporting and customer feedback. No others KPIs are currently reported, although we note that a framework for evaluating IA's performance is currently being developed. This is intended for use internally rather than the wider organisation.</p> <p><i>We recommend that the Audit and Assurance Committee provide input to this evaluation process, and monitor performance against agreed elements of the framework going forward. The evaluation criteria should be based upon IA's mission and objectives, and be specific and measurable. [Responsibility: Director of Internal Audit]</i></p>

Review of internal audit

Section Three: findings – processes (cont.)

Core indicator	Strengths	Areas for development
<p>Performance measurement <i>(continued)</i></p>		<p>File review process</p> <p>We reviewed two files included within the IA quality review process to determine the extent to which we agreed with the quality review findings. We agreed with the findings of the internal reviewers with one main exception.</p> <p>In one instance, the IA reviewer concluded that <i>'the significant risks have been considered and recorded, including the risk of fraud'</i>. We could find no evidence of explicit consideration of risk in the scoping document or audit program. We have raised a separate recommendation around this point above and have therefore not raised another recommendation here.</p>

Review of internal audit

Section Three: findings – processes (cont.)

Core indicator	Strengths	Areas for development
<p>Administration</p> <p><i>The Internal Audit function has administrative processes in place that facilitate the smooth operation of the function.</i></p>	<ul style="list-style-type: none"> ✓ IA staff record their time in electronic timesheets, ensuring that a record is maintained of utilisation, time spent on other activities, and the split of productive time between reviews. Actual time spent on reviews is captured within Auto Audit as part of the file documentation. 	
<p>Reporting</p> <p><i>Internal audit reports are prepared on a timely basis, are clear, and include graded recommendations supported by an action plan.</i></p>	<ul style="list-style-type: none"> ✓ Interim reports are graded overall to give management and the Audit and Assurance Committee a clear sense of how well a system is working. ✓ The internal audit manual provides a convention for individual recommendation grading and for converting individual gradings into an overall report assurance level ✓ Reports are concise and include areas of good practice as well as points for development. Issues are presented clearly and incorporate associated risks as well as a management action plan, including responsible officers and timescales for implementation. 	<p>Recommendation eleven: Report ratings</p> <p>It is unclear for the audience how overall assurance ratings for interim reports are arrived at in the absence of RAG rated recommendations.</p> <p>At the time of conducting our review, recommendations were not RAG rated to give the reader a detailed assessment of perceived significance. We note however that IA now intends to grade its recommendations as Priority 1, 2 or 3.</p> <p><i>Once clear priority ratings have been implemented, and acknowledging the importance of auditor judgement, the convention for converting recommendations into an overall assurance rating for a review should be communicated in the annual plan. [Responsibility: Director of Internal Audit]</i></p>

Review of internal audit

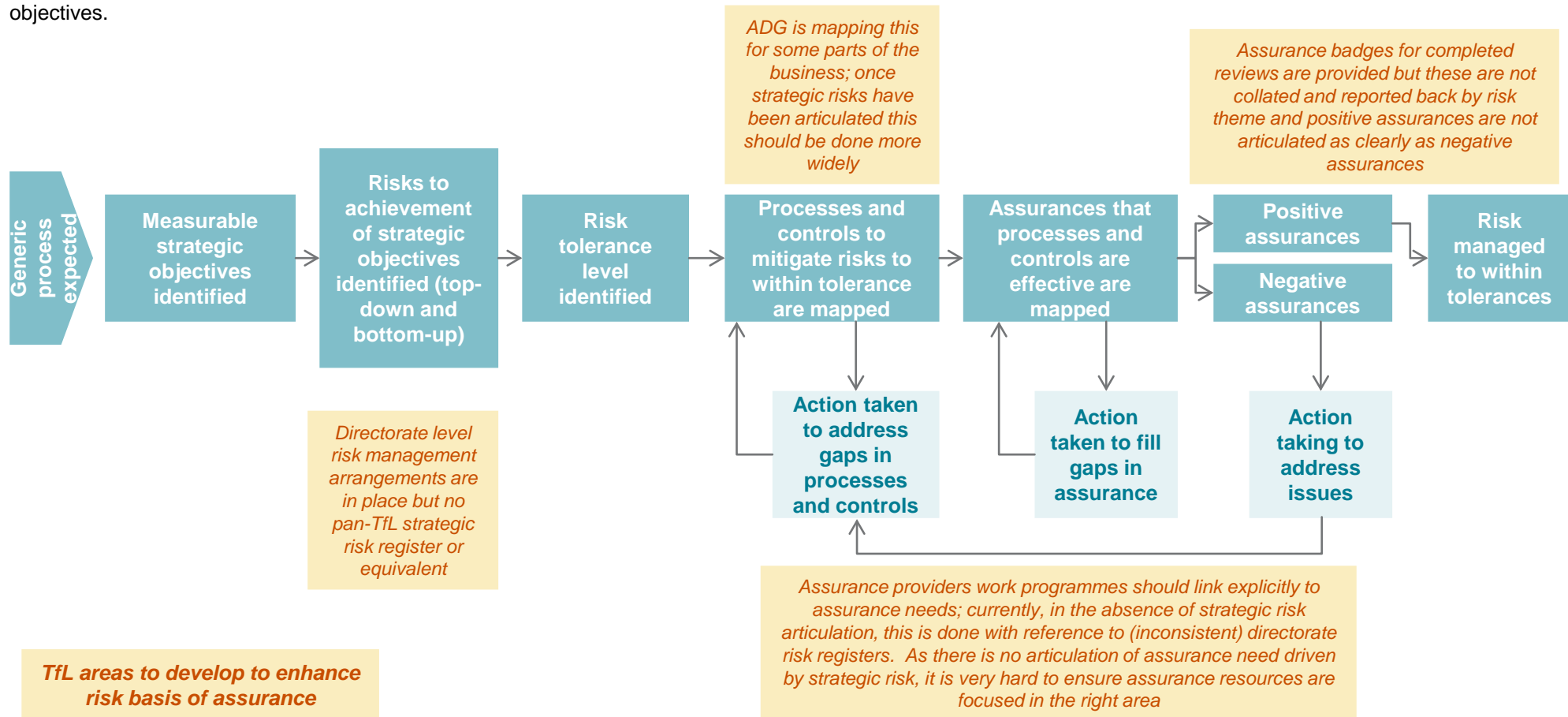
Section Three: findings – processes (cont.)

Core indicator	Strengths	Areas for development
<p><i>Reporting</i> <i>(continued)</i></p>		<p>Recommendation twelve: Positive assurance</p> <p>We note that IA reports include areas of good practice, and state the scope of reviews in broad terms and that areas not specifically mentioned in the report have been found to be operating effectively. However, reports do not state which risks have been reviewed and which procedures have been performed. Internal audit has a role in reporting positive assurance as well as exceptions. Because reports are generally written on an exceptions basis, the user is unable to determine which controls have been found to be operating effectively.</p> <p><i>We recommend that IA consider ways in which reports could be enhanced to set out more clearly positive assurances over risks that are found to be controlled effectively. [Responsibility: Director of Internal Audit]</i></p> <hr/> <p>Recommendation thirteen: Anticipated assurance</p> <p>Reports or scoping documents do not state what management expected the assurance rating to be prior to the audit work commencing. Obtaining this anticipated assurance may encourage more openness in requesting IA to perform work into areas that are known not be operating effectively and provides a sense check for the Audit and Assurance Committee on management's view of control environments.</p> <p><i>We recommend that an 'anticipated assurance' rating is obtained from relevant directors or senior officers prior to each review. [Responsibility: Director of Internal Audit]</i></p>

Appendix 1 – linking assurance to strategic risk management

Strategic risk management

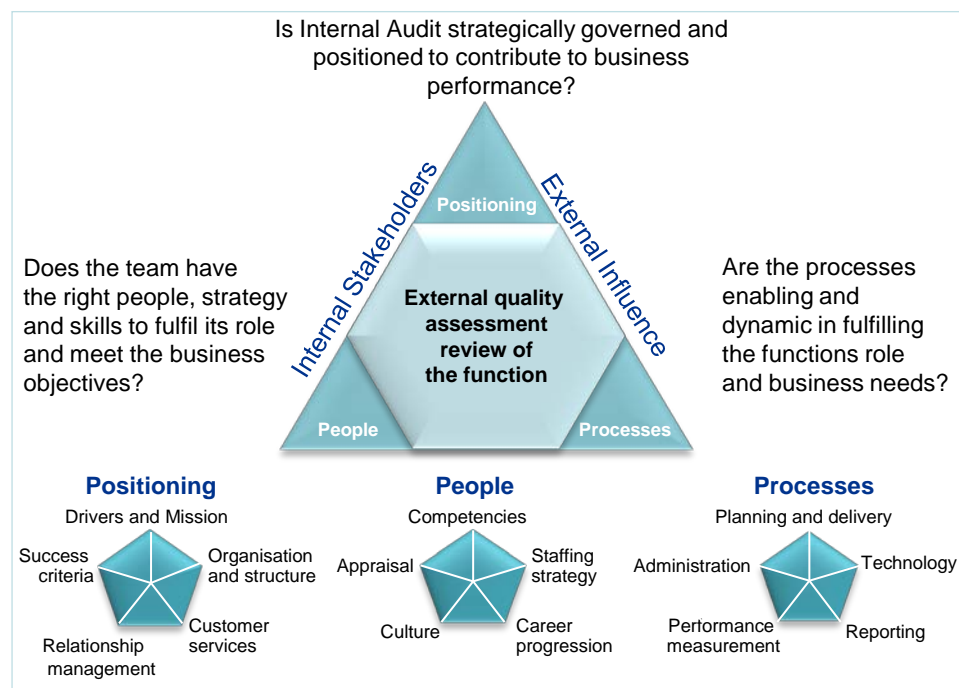
To provide context for our commentary and recommendations on strategic risk management and the impacts this has on the risk-based nature of internal audit and wider assurance plans, we have set out below the basic strategic risk management flow we expect to see in organisations and highlighted where we believe TfL needs to enhance its processes. This is focused on enhancing integrated assurance: we have not reviewed nor is it within scope to review TfL's strategy and strategic objectives.



Appendix 2 – overview of our methodology

Our methodology

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



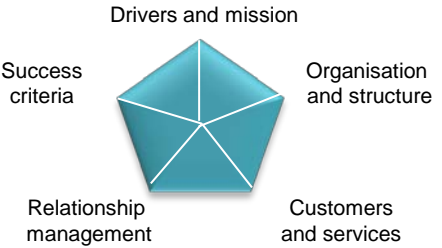
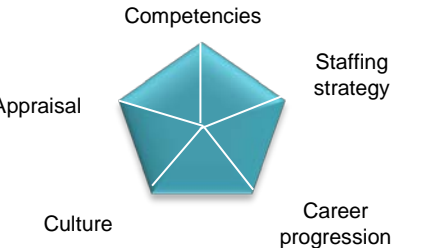
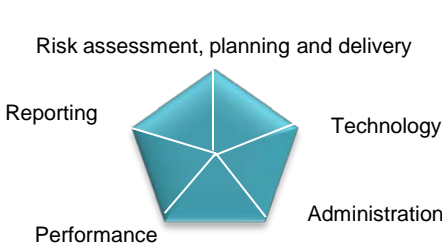
We have delivered this work in four main ways:

Consult with senior stakeholders	We used a senior KPMG team with extensive assurance experience to interview senior people in your business. They assessed the value that IA currently delivers and established where it can be developed both now and in the future. This included internal stakeholders and external stakeholders including your external audit team. Appendix 3 includes a list of interviewees.
Documentation review	We reviewed key Internal Audit documents and assessed compliance with good practice. Examples of areas of review were the Internal Audit Charter, a detailed review of methodology, KPIs and stakeholder reporting. This included a review of the progress made with integrated assurance reporting.
Review of your quality control process	Your internal audit function completes an annual quality control review and self-assessment, reviewing a sample of files for compliance with your methodology and quality expectations. This includes completion of the IIA's Quality Assurance and Improvement Programme checklist. We reviewed this quality control process and completed a sample review of two internal audit files as part of this.
Advisory panel	We shared our initial assessment and recommendations with an Advisory Panel. The Advisory Panel was comprised of relevant specialists – including leading internal audit practitioners – who brought challenge and a broader perspective to our findings, ensuring recommendations are practical and appropriate.

The following page provides more detailed insights into the key areas explored under Positioning, People and Processes.

Appendix 2 – overview of our methodology (cont.)

The table below provides more detailed insight into the key areas explored under Positioning, People and Processes.

<p>Positioning</p> 	<p>Drivers and mission</p>	<p>Are the corporate drivers for the Function appropriate? Are the mission and role defined within a wider governance framework and are they effectively communicated?</p>
	<p>Organisation and structure</p>	<p>Does the Function's structure promote objectivity and consistency? Is the structure adaptable to changes in the business environment?</p>
	<p>Customers and services</p>	<p>Are the stakeholders, users and services of the Function agreed and are they appropriate to the needs of the business?</p>
	<p>Relationship management</p>	<p>To what extent are processes in place to help the Function manage its relationships with its key stakeholders? How good is the relationship between the Function and its key stakeholders?</p>
	<p>Success criteria</p>	<p>Is the Function valuable to the business? Are there defined success criteria and are they appropriate?</p>
<p>People</p> 	<p>Competencies</p>	<p>Are the Function's core competencies directly related to its mission, role and scope of work?</p>
	<p>Staffing strategy</p>	<p>Does the Function's staffing strategy reflect its mission, role and required staff competencies? Is the strategy sufficiently flexible to respond to change in demand?</p>
	<p>Career progression</p>	<p>Does the Function have an established career progression programme that incorporates training and competency development?</p>
	<p>Culture</p>	<p>Does the Function operate in a culture which fosters the achievement of its mission and the control environment of the Group?</p>
	<p>Appraisal</p>	<p>Is the performance of individual personnel appraised against objectives which are aligned to the Functions' key performance indicators?</p>
<p>Processes</p> 	<p>Risk assessment, planning and delivery</p>	<p>Does the Function implement a good planning methodology? Does the Function have an efficient and effective delivery framework which includes high quality documentation and reporting? To what extent do the members of the function co-ordinate their work to avoid duplication, and promote knowledge sharing? How far progressed is integrated assurance reporting?</p>
	<p>Technology</p>	<p>To what extent does the Function take advantage of information technology to enhance its operations?</p>
	<p>Administration</p>	<p>What administration processes are in place to facilitate the smooth operation of the Function?</p>
	<p>Performance measurement</p>	<p>Does the Function have an appropriate framework to measure its performance? Are the performance measures in line with its critical success factors?</p>
	<p>Reporting</p>	<p>Does the Function report in a way which is effective, has impact and promotes a strong control environment and compliance culture across the Group?</p>

Appendix 3 – officers interviewed and documentation reviewed

Documentation reviewed

We reviewed the following documentation as part of this review

- Internal Audit Charter
- Performance, Planning and Review form (pro forma)
- Internal Audit Scorecard
- TfL Integrated Assurance Framework
- Internal Audit Annual Report 2011/12
- Example customer feedback form
- Customer feedback form – summary of responses for 2011/12
- Internal Audit organisational chart
- 2011/12 Internal Audit Plan
- 2012/13 Integrated Assurance Plan
- Files on Auto Audit (in relation to audits 11.102 and 11.405)
- Terms of Reference for the Assurance Delivery Group (ADG)
- Example minutes from the ADG
- Outputs from 2011/12 planning workshops
- Audit Manual
- Example job descriptions for IA roles
- Output from assurance peer review exercise
- 2012 self assessment against IIA standards
- Example review scopes and reports

Officers interviewed

We met with the following officers and stakeholders as part of this review:

- Steve Allen, Managing Director-Finance
- Keith Williams, Chair of the TfL Audit and Assurance Committee
- Howard Carter, General Counsel
- Stephen Critchley, Chief Finance Officer
- Clive Walker, Director of Internal Audit
- Senior Audit Managers
- David O'Brien, Tube Lines (Commercial)
- Ken Sanders-Fox, Tube Lines
- Andrew Pollins, Finance Director- Rail and Underground
- Sarah Atkins, Director of Commercial, Rail and Underground
- Stuart Munro, Finance Director, Tube Lines
- David Hendry, Director of Finance – Surface Transport
- Mike Strzelecki, Director of Safety
- Garrett Emmerson, Chief Operating Officer – Surface Transport
- Matthew Griffin, IM
- Andrew Quincey, Director of Commercial
- David Allen, Finance Director, Crossrail
- Heather Rabbatts, Chair of Crossrail Audit Committee
- Wayne Southwood, external audit partner



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