



# Annual Audit Letter

# Transport for the North

Year ending 31 March 2019





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# 1. EXECUTIVE SUMMARY

## Purpose of the Annual Audit Letter

Our Annual Audit Letter summarises the work we have undertaken as the auditor for Transport for the North (TFN) for the year ended 31 March 2019. Although this letter is addressed to TFN, it is designed to be read by a wider audience including members of the public and other external stakeholders.

Our responsibilities are defined by the Local Audit and Accountability Act 2014 (the 2014 Act) and the Code of Audit Practice issued by the National Audit Office (the NAO). The detailed sections of this letter provide details on those responsibilities, the work we have done to discharge them, and the key findings arising from our work. These are summarised below.

Area of responsibility	Summary
Audit of the financial statements	<p>Our auditor's report issued on 31 July 2019 included our opinion that the financial statements:</p> <ul style="list-style-type: none"><li>• give a true and fair view of TFN's financial position as at 31 March 2019 and of its expenditure and income for the year then ended; and</li><li>• have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19.</li></ul>
Other information published alongside the audited financial statements	<p>Our auditor's report issued on 31 July 2019 included our opinion that:</p> <ul style="list-style-type: none"><li>• The other information in the Statement of Accounts is consistent with the audited financial statements.</li></ul>
Value for Money conclusion	<p>Our auditor's report concluded that we are satisfied that in all significant respects, that TFN has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.</p>
Reporting to the group auditor	<p>In line with group audit instructions issued by the NAO, on 31 July 2019 we reported to the group auditor in line with the requirements applicable to TFN's WGA return.</p>
Statutory reporting	<p>Our auditor's report confirmed that we did not use our powers under s24 of the 2014 Act to issue a report in the public interest or to make written recommendations to TFN</p>

## 2. AUDIT OF THE FINANCIAL STATEMENTS

Opinion on the financial statements

Unqualified

### The scope of our audit and the results of our work

The purpose of our audit is to provide reasonable assurance to users that the financial statements are free from material error. We do this by expressing an opinion on whether the statements are prepared, in all material respects, in line with the financial reporting framework applicable to TFN and whether they give a true and fair view of TFN's financial position as at 31 March 2019 and of its financial performance for the year then ended.

Our audit was conducted in accordance with the requirements of the Code of Audit Practice issued by the NAO, and International Standards on Auditing (ISAs). These require us to consider whether:

- the accounting policies are appropriate to TFN's circumstances and have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management in the preparation of the financial statements are reasonable; and
- the overall presentation of the financial statements provides a true and fair view.

Our auditor's report, issued to TFN on 31 July 2019, stated that, in our view, the financial statements give a true and fair view of TFN's financial position as at 31 March 2019 and of its financial performance for the year then ended.

### Our approach to materiality

We apply the concept of materiality when planning and performing our audit, and when evaluating the effect of misstatements identified as part of our work. We consider the concept of materiality at numerous stages throughout the audit process, in particular when determining the nature, timing and extent of our audit procedures, and when evaluating the effect of uncorrected misstatements. An item is considered material if its misstatement or omission could reasonably be expected to influence the economic decisions of users of the financial statements.

Judgements about materiality are made in the light of surrounding circumstances and are affected by both qualitative and quantitative factors. As a result we set materiality for the financial statements as a whole (financial statement materiality) and a lower level of materiality for specific items of account (specific materiality) due to the nature of these items or because they attract public interest. We also set a threshold for reporting identified misstatements and we call this our trivial threshold.

The table below provides details of the materiality levels applied in the audit of the financial statements for the year ended 31 March 2019:

Financial statement materiality	Our financial statement materiality is based on 1.5% of gross revenue expenditure on the provision of services	£480,000
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality.	£14,400
Specific materiality	We have applied a lower level of materiality to the following areas of the accounts: - Officer remuneration bandings	£5,000

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## 2. AUDIT OF THE FINANCIAL STATEMENTS

### Our response to significant risks

As part of our continuous planning procedures we considered whether there were risks of material misstatement in TFN's financial statements that required special audit consideration. We reported significant risks identified at the planning stage to the Audit and Governance Committee within the Audit Strategy Memorandum and provided details of how we responded to those risks in our Audit Completion Report. The table below outlines the identified significant risks, the work we carried out on those risks and our conclusions.

Identified significant risk	Our response	Our findings and conclusions
<p><b>Management override of controls</b></p> <p>Management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur there is a risk of material misstatement due to fraud on all audits.</p>	<p>We performed audit procedures that covered a range of areas, including:</p> <ul style="list-style-type: none"> <li>• Material accounting estimates;</li> <li>• Journal entries, focussing on those that we determine to contain certain risk characteristics; and</li> <li>• Any significant transactions outside the normal course of business or otherwise unusual.</li> </ul>	<p>We have not identified any significant matters arising from our testing of the risk of management override of controls.</p>
<p><b>Intangible Asset valuation – Integrated and Smart Travel (IST)</b></p> <p>The IST built on existing systems to develop smart ticketing, payment and information technologies to transform travel across the whole region. The project will take a number of years to implement and is split into 3 phases and will lead to the development of an intangible asset.</p> <p>The valuation of the intangible asset required application of assumptions and estimates. TFN will need to ensure that the intangible asset is accounted for in accordance with the CIPFA Code of Practice and IAS 38 Intangible Assets. TFN has commissioned PwC to provide advice on the potential accounting treatment that will apply.</p> <p>There is a risk that assumptions and estimates are not appropriate nor in line with accounting standards.</p>	<p>We have</p> <ul style="list-style-type: none"> <li>• assessed the competency, objectivity and independence of PwC;</li> <li>• considered the instructions provided to PwC in respect of the valuation;</li> <li>• reviewed the basis of the valuation of the intangible asset and challenging the assumptions made;</li> <li>• tested transactions to ensure valuation has been appropriately applied; and</li> <li>• considered the appropriateness of the accounting treatment applied.</li> </ul>	<p>We have not identified any significant matters from our testing, and conclude that TFN's Intangible Asset valuation is materially fairly stated.</p>

## 2. AUDIT OF THE FINANCIAL STATEMENTS

Identified significant risk	Our response	Our findings and conclusions
<p><b>Valuation of Defined Benefit Pension Liability</b></p> <p>The net pension liability is likely to represent a material element of TFN's balance sheet. TFN is an admitted body of Greater Manchester Pension Fund.</p> <p>The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in TFN's overall valuation.</p> <p>Financial assumptions and demographic assumptions will be used in the calculation of TFN's valuation, such as the discount rate, inflation rates and mortality rates. The assumptions should also reflect the profile of TFN's employees, and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes.</p> <p>There is a risk that the assumptions and methodology used in valuing TFN's pension obligation are not reasonable or appropriate to TFN's circumstances. This could have a material impact to the net pension liability in 2018/19.</p>	<p>We have:</p> <ul style="list-style-type: none"> <li>• Critically assessed the competency, objectivity and independence of the Greater Manchester Pension Fund's Actuary, Hymans Robertson;</li> <li>• Liaised with the auditors of the Greater Manchester Pension Fund to gain assurance that the controls in place at the Pension Fund are operating effectively. This will include the processes and controls in place to ensure data provided to the Actuary by the Pension Fund for the purposes of the IAS19 valuation is complete and accurate;</li> <li>• Reviewed the appropriateness of the Pension Asset and Liability valuation methodologies applied by the Pension Fund Actuary, and the key assumptions included within the valuation. This will include comparing them to expected ranges, utilising information provided by PWC, consulting actuary engaged by the National Audit Office;</li> <li>• Agreed the data in the IAS 19 valuation report provided by the Fund Actuary for accounting purposes to the pension accounting entries and disclosures in TFN's financial statements.</li> </ul>	<p>In late June 2019, two legal judgements relating to guaranteed minimum pensions and transitional provisions in the Local Government Pension Scheme created additional defined benefit liabilities that not been taken account of in the actuary's estimate of the defined benefit liability as reflected in TFN's draft financial statements. To determine the significance of the changes on the reported pension liability within TFN's financial statements management requested an updated actuarial assessment which set out an estimated £95,000 increase in the pension liability as at 31 March 2019. However, based on an assessment of materiality Management decided not to make this adjustment.</p> <p>Consequently, we have no material matters to report regarding the valuation of TFN's defined benefit pension liability.</p>

# 3. VALUE FOR MONEY CONCLUSION

Value for Money conclusion

Unqualified

## Our approach to Value for Money

We are required to consider whether TFN has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The NAO issues guidance to auditors that underpins the work we are required to carry out in order to form our conclusion, and sets out the criterion and sub-criteria that we are required to consider.

The overall criterion is that, 'in all significant respects, TFN had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.' To assist auditors in reaching a conclusion on this overall criterion, the following sub-criteria are set out by the NAO:

- Informed decision making
- Sustainable resource deployment
- Working with partners and other third parties

## Significant Value for Money risks

The NAO's guidance requires us to carry out work to identify whether or not a risk to the Value for Money conclusion exists. Risk, in the context of our Value for Money work, is the risk that we come to an incorrect conclusion rather than the risk of the arrangements in place at TFN being inadequate. In our Audit Completion Report, we reported that we had identified two significant Value for Money risk(s). The work we carried out in relation to significant risks is outlined below and overleaf and our auditor's report, issued on 31 July 2019, stated that, in all significant respects, TFN put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31<sup>st</sup> March 2019.

### Risk

The development of SMART ticketing is clearly a substantial programme that represents a significant financial investment with planned expenditure of £48.6m in 2018/19. It is integral to the achievement of TFN's strategic goals. However, the latest 2018/19 budget monitoring report sets out there have been a number of delays affecting the various phases of the project and consequently it is forecast that year end expenditure is likely to be £13.1m.

### Findings

Integrated and Smart travel is a major project with Transport for the North (TFN) working with operators, transport authorities and the Department for Transport to develop and implement a scheme designed to make passenger travel simpler. Project implementation is planned over 3 phases that run concurrently with Phase three being the most significant. The project has a likely implementation date of 2021 and a had forecast expenditure of some £48m in 2018/19.

Progressing the project is dependent on DfT approval but the expected approvals have been subject to delay leading to the reduced project expenditure in 2018/19. A project of this magnitude is particularly sensitive to change and this was recognised by TFN as there were significant technological and stakeholder challenges to overcome during the year.

During 2018/19 progress has been achieved with submission and approval of the Phase 2 full business case document and received approval to progress to delivery. The IST programme's Phase 3 project received Outline Business Case approval and began to progress towards Full Business Case submission. As the project progresses key decisions on the future direction of the project will need to be determined.

(Continued overleaf)

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# 3. VALUE FOR MONEY CONCLUSION

## Findings

Detailed project management arrangements are in place that confirm clear lines of reporting and accountability right up to the main TFN Board. Structures in place covering areas that include governance, risk management and financial management. TFN has established a detailed IST Programme handbook which sets out in comprehensive detail the processes, tools and templates to be used in the management and delivery of the IST programme.

A Project Board is in place to help oversee delivery of the project. Fortnightly review meetings are scheduled that include project stakeholders and interested parties to report on progress and identify issues at an early stage.

Within the Project management Office for the scheme there is a Risk manager who works in conjunction with the main Risk Manager for TFN. There are not separate risk registers, rather a joint risk management approach is in place with project risks being included in the main Corporate Risk register of TFN and considered at various forums including the Partnership Board and the Audit & Governance Committee. Risks are managed by the project teams and Senior Project Manager and reported to Project Board then onward/upward to Exec Board.

## Conclusion

On the basis of work we completed we conclude that for 2018/19 Transport for the North had appropriate governance and financial monitoring arrangements in place.

## Risk

At the beginning of 2018 Transport for the North (TFN) received parliamentary approval to become a statutory organisation as the first Sub-national Transport Body in England. TFN brings together nineteen local transport authorities alongside Network Rail, Highways England, and HS2 Ltd to work with Central Government. Key objectives of TFN include:

- Development and implementation of the Strategic Transport Plan
- Coordination and delivery of a smart ticketing system for the whole of the North

Being established as a stand-alone entity allows TFN to hold its own funds, enter into transactions and directly employ staff. This has required TFN to implement a range of arrangements to help ensure appropriate governance, assurance and accountability processes are in place to support delivery of corporate objectives

## Findings

Our review has confirmed that TFN undertook extensive preparatory work to ensure new and appropriate governance structures were established in the run up to 1 April 2018.

TFN existed as a shadow organisation and established a shadow board that met in the weeks before receiving Parliamentary approval. The Shadow Board received a paper presented by the Chief Executive that set out proposed Governance structures and arrangements. This allowed for early discussion so that clarifications and amendments could be proposed for fuller consideration in April 2018.

TFN prepared and adopted a draft Constitution in the months prior to 1 April 2018 with an early draft of the Constitution provided to Constituent Authorities as early as March 2017. The draft Constitution was discussed and endorsed in principle by TFN's Shadow Board at its meeting on 8 February 2018.

*(Continued overleaf)*

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# 3. VALUE FOR MONEY CONCLUSION

## Findings

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The Board also:

- noted and approved key appointments and voting rights,
- established a Partnership Board and agreed membership of the Board,
- agreed the establishment and composition of an Audit and Governance Committee alongside establishment of a Scrutiny Committee and
- agreed on an appropriate schedule of meetings consistent with this.

TFN have continued to maintain an overview of the effectiveness and appropriateness of those arrangements and re-considered and adopted more appropriate arrangements where applicable with the Constitution being updated on a six monthly cycle to reflect required changes.

The constitution clearly set out a requirement for prompt establishment and maintenance of a risk register of Corporate and departmental / programme level risks as it was recognised that this would form an essential element of effective corporate governance.

TFN's approach to managing risk is set out in the Risk Management Strategy which provides guidance regarding the identification, assessment, management and reporting of risks. Each programme and corporate function within TFN has its own risk register that is updated on either a monthly or fortnightly cycle, with clear reporting in line with governance arrangements.

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## Conclusion

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On the basis of work we have completed we conclude that for 2018/19 Transport for the North had appropriate governance and risk management arrangements in place to help both deliver and progress attainment of the corporate objectives.

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## 4. OTHER REPORTING RESPONSIBILITIES

<b>Exercise of statutory reporting powers</b>	<b>No matters to report</b>
<b>Other information published alongside the audited financial statements</b>	<b>Consistent</b>

The NAO's Code of Audit Practice and the 2014 Act place wider reporting responsibilities on us, as TFN's external auditor. We set out below, the context of these reporting responsibilities and our findings for each.

### Matters on which we report by exception

The 2014 Act provides us with specific powers where matters come to our attention that, in our judgement, require reporting action to be taken. We have the power to:

- issue a report in the public interest;
- make statutory recommendations that must be considered and responded to publicly;
- apply to the court for a declaration that an item of account is contrary to law; and
- issue an advisory notice under schedule 8 of the 2014 Act.

We have not exercised any of these statutory reporting powers.

### Reporting to the NAO in respect of Whole of Government Accounts consolidation data

The NAO, as group auditor, requires us to complete the WGA Assurance Statement in respect of its consolidation data.. We submitted this information to the NAO on 31 July 2019.

### Other information published alongside the financial statements

The Code of Audit Practice requires us to consider whether information published alongside the financial statements is consistent with those statements and our knowledge and understanding of TFN. In our opinion, the other information in the Statement of Accounts is consistent with the audited financial statements.

# 5. OUR FEES

## Fees for work as TFN's auditor

We reported our proposed fees for the delivery of our work in the Audit Strategy Memorandum, presented to the audit panel in January 2019.

Having completed our work for the 2018/19 financial year, we can confirm that our final fees are as follows:

Area of work	2018/19 proposed fee	2018/19 final fee
Delivery of audit work under the NAO Code of Audit Practice	£33,000	£33,000

## Fees for other work

We confirm that we have not undertaken any non-audit services for TFN in the year.

## 6. FORWARD LOOK

### Audit Developments

#### *Code of Audit Practice*

The Code of Audit Practice sets out what local auditors of relevant local public bodies are required to do to fulfil their statutory responsibilities under the Local Audit and Accountability Act 2014. We have responded to the National Audit Office's consultation on the content of the Code (<https://www.nao.org.uk/code-audit-practice/about-code/>)

A new Code will be laid in Parliament in time for it to come in to force no later than 1 April 2020.

### Financial Reporting

#### *UK Local Government Annual Accounts*

The CIPFA/LASAAC Local Authority Code Board specifies the financial reporting requirements for UK local government. A consultation is underway to inform the direction and strategy for local government annual accounts. We will be submitting our response and suggest practitioners also voice their opinion.

#### *Lease accounting*

The implementation of IFRS 16 *Leases* in the Code is delayed until 1 April 2020. If applicable, TFN will need a project plan to ensure the data analysis and evaluation of accounting entries is completed in good time to ensure any changes in both business practice and financial reporting are captured.

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