Audit and Assurance Committee

Date: **15 June 2012**

Item 5: **KPMG Report to Those Charged with Governance**

This paper will be considered in public

1 Summary

1.1 To report to the Audit and Assurance Committee the key issues identified by KPMG during the course of their audit of the Statement of Accounts for the Transport for London Group for the year ended 31 March 2012.

2 Recommendation

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

3 Background

3.1 KPMG has prepared a report for the benefit of those charged with governance. The report outlines the respective responsibilities of the auditor and TfL, and provides an overview of the status of the audit and accounting policy changes. The report also comments on judgemental areas within the accounts. KPMG's report is attached for the Committee's review.

List of appendices to this report:

Appendix 1 – KPMG's Report to Those Charged with Governance

List of Background Papers:

None

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Transport for London

ISA260 Report to Those Charged with Governance

2011/12

7 June 2012

for presentation at the Audit and Assurance Committee

15 June 2012

Notice: about this report

This Report is subject to disclosure restrictions as set out in our appointment and engagement letters. This material is for the information of TfL. Our procedures are designed to support the provision of our audit opinion and should not be relied upon to disclose all irregularities that may exist nor to disclose errors that are not material. This report does not add or extend our duties and responsibilities as auditors reporting to the Audit and Assurance Committee.

We are committed to providing you with a high quality service. If you are in any way dissatisfied, or would like to discuss how we can improve our service, please contact Wayne Southwood, lead Partner for the TfL Group audit in the first instance. Alternatively, you may wish to contact KPMG's national contact partner for Audit Commission work, Trevor Rees (trevor.rees@kpmg.co.uk).

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

Contents

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Introduction

Background

This report to those charged with governance is made Transport for London's (TfL) Audit and Assurance Committee in order to communicate matters of interest as required by International Standards of Auditing (ISAs) (UK and Ireland), and other matters coming to our attention during our audit work that we consider relevant, and for no other purpose.

As auditors we have a responsibility for forming and expressing an opinion on the Financial Statements that have been prepared by management with the oversight of those charged with governance. The audit of the Financial Statements does not relieve management or those charged with governance of their responsibilities.

Financial Statements	Our work encompassed: ■ Audit testing of the controls over the completion of the Financial Statements; ■ An audit of the Financial Statements and associated disclosure notes; ■ Consideration of your Annual Governance Statement (AGS) to confirm that it is in line with our understanding of the business and meets CIPFA requirements; and ■ For the TfL and TTL Group Financial Statements, audit testing over your consolidation process. The findings of this work support the audit opinion that we issue on your Financial Statements.
Value for Money	Our work in this area focussed on the same two areas as last year: ■ Whether there are proper arrangements in place for securing financial resilience; and ■ Whether there are proper arrangements for challenging how TfL secures economy, efficiency and effectiveness. The findings of this work inform our value for money conclusion.

Structure of report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our findings on the audit of Financial Statements
- Section 4 outlines work that has been performed on use of resources.

Headlines

The table below summarises the work we have completed throughout the year and the results of the audit of your Financial Statements.

Financial Statements	Our audit field work is largely complete although at the time of releasing this report we have not completed a review of the final Financial Statements or of the final consolidation adjustments to support these Financial Statements. We are currently completing our post year end journal testing , a final review of the AGS and a review of subsequent events. Subject to satisfactory completion of the remaining procedures, including receipt of a management representation letter and a review of the final version of the Financial Statements, we expect to issue an unqualified opinion on TfL's Financial Statements.
Audit differences	As at 7 June 2012 we have identified 5 audit adjustments, all of which have been amended by management. The total impact of these adjustments was a £3.3m credit to the Group Comprehensive Income and Expenditure Statement. See Appendix A. We are still reviewing whether all the required disclosures have been included within the Financial Statements and will update the Audit and Assurance Committee verbally. However, we note that the current version of the Financial Statements does not include the IAS 39 requirement to disclose the aging of all receivables past due, although we do not consider this a material omission.
Recommendations	We have not identified any significant control recommendations which require reporting within this document. However, we noted a number of minor process improvement observations which we have shared with management.
Whole of Government ('WGA') Financial Statements	To achieve greater efficiencies we combined some of our testing on the production of the WGA with our regular audit work. We will complete the remainder of our work on the WGA in August 2012 and anticipate meeting the deadline of 1 October 2012. We are also required to provide the Auditors of the GLA Group with group reporting in relation to the consolidation of the whole GLA family.
Fraud	We have a responsibility to consider fraud and we addressed this in our assessment of TfL's controls framework. We have also reviewed the arrangements established for the prevention and detection of fraud and corruption. We have not identified any matters related to these areas to bring to your attention, other than those which have already been communicated to you by Internal Audit.
Use of resources and certification	Our work on this area is complete and we anticipate issuing an unqualified opinion. We are required to certify that we have completed the audit of the Financial Statements in accordance with the requirements of the Code. If there are any circumstances under which we cannot issue a certificate, then we must report this to those charged with governance. There are no issues that would cause us to delay the issue of our certificate of completion of the audit.

Below are outlined the activities we have completed throughout 2011-12. We have completed these activities in line with our Audit Plan presented to the Audit Committee in November 2011. We have highlighted the areas we are yet to complete. There is nothing to indicate this timetable will not be met.

	Stage	Activity	October	November	December	January	February	March	April	May	June	July
1	Planning	Determine risk assessment procedures and identify risks.	●	●								
		Determine audit strategy.	●	●								
		Determine planned audit approach.		●								
		Review internal audit findings and scope reliance.		●								
2	Control evaluation	Understand accounting and reporting activities.		●								
		Evaluate design and implementation of selected controls.		●								
		Test operating effectiveness of selected controls.		●					●			
		Assess overall risk of material misstatement.		●	●				●			
3	Substantive procedures	Plan substantive procedures.						●	●			
		Perform substantive procedures.							●	●	●	
		Consider if audit evidence is sufficient and appropriate.									●	
		Perform work on consolidation.								●	●	
4	Finalisation	Perform completion procedures.										●
		Perform overall evaluation.										●
		Form an audit opinion.										●
		Audit and Assurance Committee reporting.			●				●		●	

These final activities are due to take place after the Audit and Assurance Committee

We have already reported the key findings from stage one in our previous communications with you. In the remainder of this section, we report our findings from stages two to four and discuss the representations required to complete stage four.

Financial Statements (cont.)

Financial Statements production	We received complete draft Financial Statements packs on 23 April 2012 in accordance with the agreed timetable. We received the consolidation model and the draft Group Financial Statements on 17 May 2012. TfL's working papers to support the Financial Statements were of high quality and our 'prepared by client' (PBC) list had been followed. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of CIPFA/LASAAC Code of Practice on Local Authority Accounting. TfL's finance staff were available throughout the audit visit to answer our queries as they arose. We would like to thank the finance team for their co-operation throughout the visit which allowed the audit to progress smoothly and complete within the allocated timeframe.
Testing	Our findings relating to areas of high audit risk are shown on slides 7 to 10.
Representations and opinions	The Chief Finance Officer is required to provide us with representations on specific matters such as TfL's financial standing and whether the transactions in the Financial Statements are legal and unaffected by fraud. We have attached a copy of the proposed form of this letter at Appendix B.
Other matters	There were no changes to materiality made in the course of the audit work. We are required under ISA260 to communicate to you any matters specifically required by other auditing standards to be communicated to those charged with governance; and any other audit matters of governance interest. We have not identified any other matters of concern.

Next steps

Once we have received the required representations and carried out our subsequent events review we issue our audit opinion. For 2011-12 this provides confirmation that:

- The Financial Statements present a true and fair view of the state of the Group's and Corporation's affairs as at 31 March 2012; and
- The Financial Statements have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

Independence and objectivity

ISA 260 also requires us to make an annual declaration that we are in a position of sufficient independence and objectivity to act as your auditors. We have provided this declaration in our Independence Letter.

Financial Statements (cont.)

Key audit risks	Work done	Conclusion
IT controls including access rights and segregation of duties **Audit areas affected** ■ All financial statement captions	Work was undertaken in 2010-11 to assess the configuration of the SAP Governance Risk and Compliance 'Segregation of Duties' controls with a number of instances of conflicts identified in accounts payable and receivable. The results of our work were shared with Internal Audit and SAP Security & Authorisations for the purposes of updating business rules in the GRC tool. We have not repeated this work in 2011-12, but assessed the ongoing governance processes around access administration and change management with a view to providing assurance over the ongoing effectiveness of specific financial controls operating within the SAP environment over the financial year. Our high level findings are as follows: ■ At the time of our work we noted that service accounts were being shared by a number of support users thereby removing accountability for actions taken. Management responded that they will assign individual named accounts for SAP support activities and look to put in place a control to periodically verify the appropriateness of access permissions assigned to generic accounts. ■ User management permissions had been assigned to a handful of users outside of the IM Support team. There is currently no process in place for management to periodically validate the appropriateness of user access permissions within their departments which may have identified this. In order to improve control over access rights the GRC tool has been configured to raise alerts to access approvers when conflicting access permissions (as defined by the business) are assigned to users. However, this tool will not identify where a user has retained access to a function or transaction that is no longer required.	No material issues noted. We will review progress in future periods.
Funding **Audit areas affected** ■ Grants ■ Funding ■ Financial standing	TfL like other local government bodies had its funding reviewed in 2010. The output of this exercise was a funding settlement from the government which set out how much grant and other funding will be received over the next four years along with an outline of the borrowing levels permitted. The Crossrail project is funded through a variety of mechanisms, the significant elements of which are passed through the DfT and through TfL. Of the £14.8bn funding required over the life of the project some £7.1bn will be provided by TfL through a variety of sources. There are a number of conditions attached to both the government funding (mainly associated to the delivery of the TfL Business Plan and Investment Programme) and the Crossrail project funding which must be met to ensure this funding is continued. We will continue to review these conditions and assess TfL's compliance with them in the short term (defined as twelve months from the date we plan to sign the Financial Statements – i.e. July 2013) up to the are of signing our audit opinion.	Nothing came to our attention that would suggest the conditions had not been complied with during the period under review. We will continue to keep this area under review until the date of signing the Financial Statements

In this section we provide an update on the risk areas highlighted for focus in our planning memo:

Key audit risks	Work done	Conclusion
Procurement **Audit areas affected** ▪ Expenditure and creditors ▪ Controls	We have reviewed controls over key processes such as awarding of contracts, raising and approval of POs, matching them to invoices and supplier payments. We have involved our Forensic team to perform certain additional procedures on supplier bank detail changes, no significant issues were noted through our testing. We have followed up on our finding from the previous year wherein certain POs were raised directly in SAP as opposed to them being raised through the e-procurement module. Management have built in an additional control whereby only in exceptional circumstances is the e-procurement module not used to raise POs. Our testing of this control did not reveal any significant issues during the current year. We have reviewed relevant internal audit reports across subsidiaries on procurement and related areas and no issues were noted from the work undertaken.	No material issues noted
Highly paid employees **Audit areas affected** ▪ Financial statement presentation	TfL is required under the LG Code to publish certain remuneration details of all senior employees; defined as being those whose annualised salaries are £150,000 or above. Salary bandings disclosures are also required for employees of the Corporation with total remuneration of £50,000 or above. This banding disclosure is only applicable to the Corporation and not the employees of the wider group, although we note that for some years TfL have provided this disclosure on a Group wide basis on a voluntary basis. There is also a new requirement to disclose exit packages within the Financial Statements. For the year ended 31 March 2012 there has been a change in the basis of the presentation of the senior employees remuneration from a cash to an accruals basis – this is consistent with information elsewhere in the Financial Statements and is permissible under the Code. The prior year has been restated. We reviewed the process by which these disclosures are generated, and found it to be sufficiently robust. Our detailed testing of the disclosure is ongoing.	No material issues noted
Revenue recognition **Audit areas affected** ▪ Revenue	We reviewed the revenue collection processes for key commercial revenue streams (fares and ticketing as well as congestion charging). No issues were noted around the accounting and financial arrangements in these areas. Our work on the IT aspects of the ticketing system did not highlight any deficiencies. Our work on cash receipting did not reveal any material weaknesses, although we did identify a need to strengthen controls in relation to the monitoring of cash receipts by the FSC. We performed additional work in this area and identified some suggested improvements in relation to the oversight of third party contracts in relation to the congestion charging scheme and these have been reported to management.	No material issues noted

Financial Statements (cont.)

Key audit risks		Work done	Conclusion
Project Horizon	**Audit areas affected** ■ Provisions ■ Revenue ■ Fixed Assets ■ Purchasing	TfL underwent an organisational change programme 'Project Horizon' in 2011-12, and a new organisational structure has since been embedded. As part of Project Horizon a severance programme was undertaken. Our testing found that substantially all payments to employees had been made prior to the year end and as such no provision for severance was necessary as at 31 March 2012. We note that from a systems perspective the timing of changes did not materially impact our audit work and there continues to be appropriate segregation of duties for key processes.	No material issues noted
Prudential indicators	**Audit areas affected** ■ Funding ■ Borrowing	Under the Local Government Act 2003 the Mayor must determine and keep under review how much money TfL and the other functional bodies can afford to borrow. TfL may not borrow money if doing so would result in a breach of this limit. TfL has voluntarily developed a set of specific local indicators, referred to as voluntary or discretionary indicators, calculated on the basis of the Group Financial Statements. The limits were extended in the current year to take account of the acquisition of CARE and WARE. We have reviewed TfL's performance against these prudential indicators as part of our audit work and note that TfL have managed their finances within the agreed target.	No material issues noted
Claims provisions and accruals	**Audit areas affected** ■ Provisions, contingent liabilities and accruals	During the year a number of significant claims have either been settled or negotiations have progressed positively with the parties involved. We have met with management to discuss and understand the status of any outstanding claims and basis of any provision held. We have also reviewed the assumptions underpinning the judgement and reviewed supporting documentation. Further, we have met with the Legal and Disputes Resolution teams to get an independent view of the merits of each claim and to confirm their completeness. We have held discussions with project accountants to understand the basis for year end accruals and obtained necessary evidence wherever possible to substantiate the amounts accrued and commitments disclosed. Based on our discussions held and review of the supporting documentation we concur with management's position and the overall level of provisioning and disclosure.	No material issues noted

Financial Statements (cont.)

Key audit risks	Work done	Conclusion
Capitalisation of costs **Audit areas affected** ▪ Fixed assets ▪ Depreciation	We have reviewed a sample of additions to fixed assets and challenged the nature of the expenditure – CAPEX vs OPEX. For projects selected for review we have held discussions with project accountants and engineers on site to understand how these costs would produce economic benefits in the future. Our work in this area has not identified any errors. The quantum of project write offs during the year is not material – we have held discussions with management to understand the rationale for these write offs and confirmed necessary approvals were gained.	No material issues noted
Treasury activities **Audit areas affected** ▪ Investments ▪ Hedging ▪ Financial statement presentation	TfL have put into place a long term financing plan to issue debt for the period covered by the Spending Review. The key judgment within the Treasury accounting relates to the effectiveness or otherwise of the hedges taken out in the prior year in relation to the future borrowing strategy for the TfL Group. In March 2012 the TfL Board approved a borrowing strategy as part of its annual Treasury Management Strategy, which includes the issuance of 10 and 30 year debt. Management have considered the 'highly probable' criteria in relation to future borrowings and concluded that under current likely scenarios this continues to be met. Accordingly the hedges are considered effective and the marked to market fair value associated with these financial instruments (£117m) has correctly been deferred within reserves. We concur with the accounting that has been applied. The remaining £1,133m of A1 loan notes and £87m of A2c notes in Tube Lines (Finance) Plc were restructured in year at a premium of £217m over the cash value of the loans repaid. £232m debt (A notes, B notes and debentures) purchased as part of the CARE and WARE transactions was also restructured in the year. These borrowings were replaced with Commercial paper in TfL. EIB debt in WARE and Tube Lines (Finance) Plc was novated to TfL in February 2012. This resulted in a fair value adjustment in the books of TfL Corporation but not in the books of the Group as a whole. To fund the refinancing of the above debt and the incremental authorised borrowings requirement for the year a floating rate note was issued under the Euro MTN programme (£300m) and Commercial Paper totalling £1.4bn was issued by TfL during the year. An additional £200m of EIB debt was also drawn down by TfL in the year.	No material issues noted.

Use of resources

Introduction

We have a responsibility to assess the extent to which proper arrangements have been put in place to secure economy, efficiency and effectiveness in TfL's Use of Resources (UoR). We give a conclusion on whether or not arrangements are satisfactory. To fulfil this responsibility we are required to review TfL's corporate performance management and financial management arrangements.

Overview of the VFM audit approach

The key elements of the VFM audit approach are summarised below.

The two questions which are the focus of the VFM work are as follows:

1. The organisation has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.
2. The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

The answers to these questions were completed based on our understanding from previous years, incorporating any changes during the year. Our work on the Financial Statements (for example, entity level control testing) provided additional evidence in forming our opinion in value for money. Our previous work with TfL showed significant changes to the Business Plan were made during 2010-11 as an immediate response to the Comprehensive Spending Review 2010.

VFM Conclusion

On the basis of our work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2011, we are satisfied that, in all significant respects, the Corporation put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2012.

Appendices

ISA260 communication of audit differences

We are required by ISA (UK and Ireland) 260 Communication of Audit Matters to Those Charged with Governance to communicate all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance. We are also required to report all material misstatements that management has corrected but that we believe should be communicated to the Audit and Assurance Committee to assist it in fulfilling its governance responsibilities.

This appendix sets out the audit differences that we identified following the completion of our audit of TfL for the year ended 31 March 2012.

Unadjusted audit differences

We are pleased to report that there were no unadjusted audit differences. However we note that the Financial Statements do not include the IAS 39 requirement to disclose the aging of all receivables past due, although we do not consider this a material omission.

Adjusted audit differences

We identified a number of adjustments which were above our posting threshold but below our performance materiality threshold (both individually and in aggregate). The net impact of these adjustments was a £3.3m credit to the Group Comprehensive Income and Expenditure Statement .

We are currently reviewing the disclosures in the Financial Statements.

Presentational Issues

We identified a number of minor presentational issues during our audit, all of which have been amended by the management.

Other matters

There are no other matters which we need to bring to the attention of those charged with governance.

Appendix B – Proposed Form of Representation Letter

KPMG LLP
15 Canada Square
London
E14 5GL

[Date]

Dear Sir

This representation letter is provided in connection with your audit of the financial statements of Transport for London ('the Corporation') and the consolidated financial statements of the Transport for London Group ('the Group'), for the year ended 31 March 2012 for the purpose of expressing an opinion as to whether these financial statements:

- give a true and fair view of the state of the Group's and the Corporation's affairs as at 31 March 2012 and of the Group's and Corporation's expenditure and income for the year then ended; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

These financial statements for the year ended 31 March 2012 comprise the Group and Corporation Balance Sheets, the Group and Corporation Comprehensive Income and Expenditure statements, the Group and Corporation Movement in Reserves Statement and the Group and Corporation Cash Flow Statements for the year then ended, and the related notes.

I confirm that the representations I make in this letter are in accordance with the definitions set out in the Appendix to this letter.

I confirm that, to the best of my knowledge and belief, having made such enquiries as it considered necessary for the purpose of appropriately informing myself:

Financial statements

1. I have fulfilled my responsibilities, as set out in the terms of the audit engagement for the year ended 31 March 2012, for the preparation of financial statements that:

    - give a true and fair view of the state of the Group's and the Corporation's affairs as at the end of its financial year and of the Group's and Corporation's expenditure and income for the year then ended;
    - have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12; and
    - have been prepared on a going concern basis.

2. Measurement methods and significant assumptions used in making accounting estimates, including those measured at fair value, are reasonable.

3. All events subsequent to the date of the financial statements and for which the Code of practice on Local Authority Accounting in the United Kingdom 2011/12 require adjustment or disclosure have been adjusted or disclosed.

4. The effects of uncorrected misstatements are immaterial, both individually and in aggregate, to the financial statements as a whole.

Information provided

5. I have provided you with:

   - access to all information of which I am aware, that is relevant to the preparation of the financial statements, such as records, documentation and other matters;
   - additional information that you have requested from me for the purpose of the audit; and
   - unrestricted access to persons within the Group and the Corporation from whom you determined it necessary to obtain audit evidence.

6. All transactions have been recorded in the accounting records and are reflected in the financial statements.

7. I acknowledge my responsibility for such internal control as I determine necessary for the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In particular, I acknowledge my responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.

   I have disclosed to you the results of my assessment of the risk that the financial statements may be materially misstated as a result of fraud. Included in the Appendix to this letter are the definitions of fraud, including misstatements arising from fraudulent financial reporting and from misappropriation of assets.

8. I have disclosed to you all information in relation to:

   (a) Fraud or suspected fraud that I am aware of and that affects the Group and the Corporation and involves:
      - management;
      - employees who have significant roles in internal control; or
      - others where the fraud could have a material effect on the financial statements; and

   (b) allegations of fraud, or suspected fraud, affecting the Group and the Corporation's financial statements communicated by employees, former employees, analysts, regulators or others.

9. I have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements. Further, I have disclosed to you and have appropriately accounted for and/or disclosed in the financial statements in accordance the Code of Practice on Local Authority Accounting in the United Kingdom 2011/12, all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements.

10. I have disclosed to you the identity of the Group's and the Corporation's related parties and all the related party relationships and transactions of which I am aware and all related party relationships and transactions have been appropriately accounted for and disclosed in accordance with The Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

11. I confirm that:

(a) The financial statements disclose all of the key risk factors, assumptions made and uncertainties surrounding the Corporation's and Group's ability to continue as a going concern as required to provide a true and fair view.
(b) Any uncertainties disclosed are not considered to be material and therefore do not cast significant doubt on the ability of the Corporation and the Group to continue as a going concern.

12. On the basis of the process established and having made appropriate enquiries, I am satisfied that the actuarial assumptions underlying the valuation of pension schemes liabilities are consistent with my knowledge of the business. I further confirm that all significant retirement benefits, including any arrangements that:

    - are statutory, contractual or implicit in the employer's actions;
    - arise in the UK and the Republic of Ireland or overseas;
    - funded or unfunded; and
    - approved or unapproved

have been identified and properly accounted for; and
all settlements and curtailments have been identified and properly accounted for.

13. I confirm that:

    - [TBC]; and
    - [TBC]

These Financial Statements were approved by the Board on [TBC] July 2012.

Yours faithfully,

Stephen Critchley
Chief Finance Officer

cc: Audit Committee

<u>Appendix A to the Representation Letter of Transport for London: Definitions</u>

Financial Statements

A complete set of financial statements comprises:

- Group and Corporation statements of financial position as at the end of the period;
- Group and Corporation statements of comprehensive income for the period;
- Group and Corporation statements of changes in equity for the period;
- Group and Corporation statements of cash flows for the period;
- notes, comprising a summary of significant accounting policies and other explanatory information;
- a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

Material Matters

Certain representations in this letter are described as being limited to matters that are material.

IAS 1.7 and IAS 8.5 state the following:

Material omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

Fraud

Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users.

Misappropriation of assets involves the theft of an entity's assets. It is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorisation.

Error

An error is an unintentional misstatement in financial statements, including the omission of an amount or a disclosure.

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

(a) was available when financial statements for those periods were authorised for issue; and
(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Management

For the purposes of this letter, references to "management" should be read as "management and, where appropriate, those charged with governance".

Related party

A related party is a person or entity that is related to the entity that is preparing its financial statements (referred to in IAS 24 *Related Party Disclosures* as the "reporting entity").

(a) A person or a close member of that person's family is related to a reporting entity if that person:
  (i) has control or joint control over the reporting entity;
  (ii) has significant influence over the reporting entity; or
  (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

(b) An entity is related to a reporting entity if any of the following conditions applies:
  (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
  (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
  (iii) Both entities are joint ventures of the same third party.
  (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
  (v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
  (vi) The entity is controlled, or jointly controlled by a person identified in (a).
  (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

A reporting entity is exempt from the disclosure requirements of IAS 24.18 in relation to related party transactions and outstanding balances, including commitments, with:

(a) a government that has control, joint control or significant influence over the reporting entity; and
(b) another entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity.

Related party transaction

A transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.

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