

# FSC Newsletter

Number 11 Year 2012



Financial Services  
Commission

## Enhancing the confirmations provided by Statutory Auditors and Audit firms for the Capitalisation of Licenced Companies

### Introduction

This newsletter provides guidance to those auditors and audit firms (the "Auditors") who are required to provide confirmation to the Financial Services Commission ("FSC") in respect of the capitalisation of licenced firms (the "Licensee").

This newsletter clarifies what the FSC considers appropriate standards and procedures to maximise the value of these confirmations for regulatory purposes.

### General Approach

The FSC accepts that these procedures do not constitute an audit and as such audit procedures and auditing standards may not be appropriate. However, the FSC expects that Auditors plan and perform Agreed-Upon procedures with a high degree of professional scepticism.

The FSC acknowledges that the primary responsibility for the prevention and detection of fraud falls with those charged with governance and management of the Licensee. Whilst it is recognised that statements and documents produced for these purposes will generally be genuine, professional scepticism should always be at the forefront of the Auditor's mind.

Auditor's should be aware of their obligation to communicate with the FSC under the Supervisory Acts, in particular in respect of such matters identified which should be brought to the FSC's attention by way of a separate communication, not involving the client or potential client.

Notwithstanding this, any matters of relevance identified by the Auditors should be explicitly stated by the Auditors in their report unless there is a risk of "tipping off" under section 5 of the Crime (Money Laundering and Proceeds) Act. Where there is a risk of a tipping-off offence occurring because of a disclosure that should be made in the report but isn't, the Auditors should consider their obligation to communicate with the relevant authority.

### Framework

The FSC is mindful that the work of Auditors in relation to these confirmations would not generally be captured by existing audit engagement letters. When preparing confirmations, relating to the initial or additional capitalisation of a Licensee, the FSC requires that these engagements are undertaken under the International Standard on Related Services 4400 ("ISRS 4400") "Engagements to Perform Agreed-Upon Procedures Regarding Financial Information".

The pro forma report in appendix A complies with the requirements of this standard.



## **Terms of Engagement**

The FSC expects that the terms of engagement between Entities and their Auditors will include provision for the FSC to receive a copy of their report directly from the Auditors as a matter of course.

## **Procedures and work expected**

The FSC would expect Auditors to perform the necessary procedures to ensure that statements made in their report are factually correct and can be substantiated to supporting documents.

The FSC would expect that Auditors perform the following procedures with regards to the Agreed-Upon procedures:

- Ensure that the shares issued are in agreement with the Licensee's/Applicant's statutory records; and
- Agree the funds received by the Licensee/Applicant to supporting documentation (see below sections on confirmations and evidence).

In undertaking the above, Auditors should consider procedures such as:

- Inquiry and analysis;
- Re-computation, comparison and other accuracy checks;
- Observation;
- Inspection;
- Obtaining confirmations.

Upon completion of the above procedures, the FSC will require the Auditor to prepare and submit to the FSC directly a report setting out the work performed by the Auditor highlighting where appropriate any exceptions identified during the process.

A pro forma report is set out in appendix A and examples of matters that the FSC would require to be highlighted in the report are set out below.

## **Confirmations and evidence**

Evidence obtained by the Auditor will be more reliable when obtained from independent sources outside of the Licensee. This should be obtained directly by the Auditor and will be more reliable when it exists in documentary form, whether paper, electronic or other medium. Evidence is also more reliable in the form of original documents rather than evidence in the form of photocopies or facsimiles.

Unless explicitly stated, the following terms have the meanings attributed below:

- External confirmation – Evidence obtained as a direct written response to the Auditor from a third party (the confirming party), in paper form, or by electronic or other medium.
- Positive confirmation request – A request that the confirming party responds directly to the Auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.
- Negative confirmation request – A request that the confirming party respond directly to the Auditor only if the confirming party disagrees with the information provided in the request.
- Non-response – A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.
- Exception – A response that indicates a difference between information requested to be confirmed, or contained in the Licensee's records, and information provided by the confirming party.



The FSC considers that only positive confirmation requests would be appropriate when seeking confirmation of ownership and existence of assets transferred as consideration for the shares issued. Auditors must maintain control of the confirmation process and ensure that this is independent of the Licensee. Factors to consider should include:

- An assessment and selection of the information to be confirmed or requested;
- An assessment and selection of the appropriate confirming party;
- An assessment and determination that requests are properly addressed and contain return address information for responses to be sent directly to the Auditor; and
- Ensuring that the sending of the requests, including follow-up requests, are controlled by the Auditor.

When making an assessment of the confirming party, the Auditor should check via independent means whether the confirming party is appropriate. For example, the Auditor should check that a confirming party has an appropriate licence to hold those assets.

Auditors should consider whether confirmations are genuine and the FSC expects that consideration should be given as to the validity of addresses and other contact details on confirmation requests and responses. Where the Auditor is unable to verify the authenticity of the confirming party via independent means, this should be explicitly stated in their report.

When a response is returned to the Auditor indirectly e.g. the confirming party incorrectly addressed it to the Licensee rather than to the Auditor, the Auditor should request the confirming party to respond in writing directly to the Auditor.

Auditors should consider the use of an electronic process where available. This process often creates a secure environment for responses and may mitigate the risks that are evident with paper documentation. If Auditors are satisfied that these processes are secure and properly controlled, the reliability of the related responses is often enhanced. Often, an electronic confirmation process can incorporate various techniques for validating the identity of a sender of information in electronic form, for example, through the use of encryption, electronic digital signatures, and procedures to verify web site authenticity. These are procedures that are welcomed by the FSC.

### **Provenance of funds – cash subscriptions**

The FSC requests that the Auditor includes in their confirmation a statement as to the provenance of the consideration for the share subscription. The FSC only requires information as to who has deposited the funds received by the Licensee. This will generally be consistent with the allottee of the shares but where this is not consistent or this could not be verified, this should be explicitly stated on their report.

### **Provenance of funds – other**

When the consideration for the shares issued is not cash (or cash equivalents), the FSC requests that the Auditor set out in their report who the assets transferred were previously registered to. This will generally be consistent with the allottee of the share capital and where this is not consistent or this cannot be verified, this should be explicitly stated on their report.



## **Valuation of assets transferred**

It is the responsibility of those charged with governance and management of the Licensee to ensure that the consideration received for any shares issued is sufficient and adequate for capitalisation purposes. The FSC would expect Auditors to verify the value of the assets received by the Licensee to independent sources and that the value and source of valuation be disclosed in their report. Where this cannot be reasonably undertaken, e.g. with unlisted investments, this should be explicitly stated on their report.

## **Charges, Mortgages, Loans or Liens**

Auditors should undertake the following procedures:

- obtain confirmation from the directors whether there are any charges, mortgages, or loans or other liens over the assets.
- Review the statutory records for evidence of any charges, mortgages, or loans or other liens over the assets.

A statement to this effect should also be included in the report.

## **Matters that the FSC would require be highlighted in the report.**

The following is not an exhaustive list but represents practical examples to help Auditors understand the type of matters that the FSC would consider appropriate that Auditors highlight in their report:

- Transactions not recorded in a complete or timely manner or transactions improperly recorded as to amount, accounting period, classification etc.;
- Unavailability of documents in original form when these are expected to exist;
- Unsupported balances;
- Unusual discrepancies between the entity's records and confirmation replies;
- Unusual delays in receipt of information;
- Errors in documents received and suspicions re documents that appear to have been altered;
- Suspicions regarding addresses provided;
- Inconsistencies between address, phone numbers or other contact details shown on statements and documents and those available on web-sites, etc. for the same firm;
- Unusual addresses or locations from which the information is received (e.g. from locations which do not have any apparent link with the entity concerned);
- Use of personal e-mail addresses, mobile phone or other contact details; and
- Where the entity's management have refused to allow the Auditor to send a confirmation request, including the reasons for refusal and what alternative actions have been taken;
- Where the appropriate confirming party could not be assessed by the Auditor by independent means;
- For any non-responses, these should be stated with details about what alternative actions have been taken by the Auditor;
- Details of any other exceptions arising regarding the confirmation process or the evidence obtained.
- Inconsistencies between evidence.

## **Report**

Appendix A provides a pro forma confirmation to be submitted to the FSC in relation to this area going forward.



## Appendix A

### **Auditor's certification of capitalisation to the Board of directors of [Licensee/Applicant's name] and the Financial Services Commission.**

We have performed the procedures agreed with you and enumerated below with respect to the capitalisation of [Licensee/Applicant name] ("the Licensee") and the related share allotment on [insert date], set forth below. Our engagement was undertaken in accordance with the International Standard on Related Services ("ISRS 4400") applicable to agreed-upon procedures engagements. The procedures were performed solely to assist you in evaluating the validity of the Licensee's capitalisation and related share allotment. The procedures performed have been in accordance with our engagement letter dated [insert date] and the Financial Services Commissions Newsletter 11 of 2012 unless explicitly stated.

#### **Details of the capitalisation**

[Funds/Assets\*] of [type, amount & currency\*] were received into [Licensee name]'s ("the Licensee") [bank/investment manager\*] account number [number] at [name of bank/investment manager\*] on [date] as consideration for the issue of shares as set out below and a copy of the [bank/investment manager\*] statement has been verified by [describe how verified]. These [Funds/Assets\*] were [received from/previously registered to\*] [direct source of funds] as [verified by agreement to the Bank statement/confirmed by the bank\*].

The Licensee's records show that [Number of Ordinary shares/Preference shares/amount of Loan Stock\*] were issued as [fully/partly paid\*] on [date] to the following [share and stockholders] shown below:

[Shareholder] – [Number and type of shares] for an amount of [currency and amount].

The Licensee's records show that the authorised and paid up shares of the Licensee is as follows:



**Authorised share capital:**

[Number of Ordinary Shares] at [Currency and amount] Nominal Value	XXX	
[Same for Preference Shares and Loan Stock but no Premium on Loan Stock]	XXX	
Total authorised share capital	<hr/>	XXX
<b>Paid up share capital:</b> (Shares (and/or Loan Stock))		
[Number of Ordinary Shares] at [Currency and amount] Nominal Value	XXX	
[Same for Preference Shares and Loan Stock but no Premium on Loan Stock]	XXX	
Total nominal value of issued and partly paid up share capital	<hr/>	XXX
[Number of Ordinary/Preference Shares*] at a Premium of [Currency and amount]	XXX	
Total premium on paid up share capital		<hr/>
Total		<hr/> <hr/>

**Charges, Mortgages, Loans or Liens**

The directors have confirmed that the [Funds/Assets] [are/are not] subject to charges, mortgages, loans or liens, and [our review of the statutory records has not highlighted any matters which indicate that the [Funds/Assets] are subject to charges, mortgages, loans or liens/has highlighted the following matters:]

No further matters were identified which should be reported in accordance with the FSC's Newsletter 11 of 2012.

OR

The following matters were identified which should be reported in accordance with the Financial Services Commission's Newsletter 11 of 2012:

- List items to disclose

Because the above procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing or International Standards on Review Engagements, we do not express any assurance on the statements above.

Had we performed additional procedures or had we performed an audit or review of the financial statements in accordance with International Standards on Auditing or International Standards on Review Engagements, other matters might have come to our attention that would have been reported to you in accordance with the FSC's newsletter 11 of 2012.

Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose. Furthermore, our report should be restricted to those parties which have agreed to the procedures to be performed since other parties, unaware of the reasons for the procedures, may misinterpret the results. The report may only be distributed by the FSC on the express condition that:

- the report is distributed in its entirety, including an explanation of the procedures agreed as contained in the FSC's Newsletter 11 of 2012;
- the recipient agrees not to reference or distribute the report to any other party, and understands that the furnishing of the report and the procedures undertaken is not a substitute for their own procedures;



- the recipient agrees to place no reliance on this report or the data contained herein that would result in the creation of any duty of care or liability; and
- the recipient is in agreement with these terms and conditions by retaining a copy of the report.

This report relates only to the work undertaken as set out above and does not extend to any financial statements of [Licensee Name], taken as a whole.

Signed

[Auditor]

[Auditor Address]

[Date]

\* delete as appropriate

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