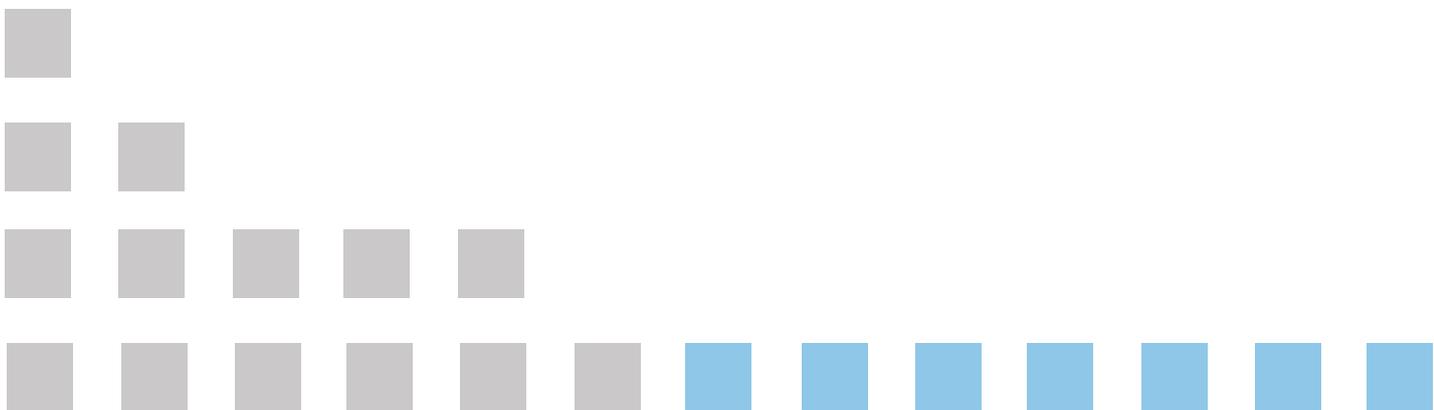


Annual Report on Audit Supervision

2016 - 2017



Introduction

The Gibraltar Financial Services Commission (“GFSC”) is the competent authority for Statutory Auditors conducting Statutory Audits in Gibraltar as designated in the Financial Service (Auditors) Act 2009 (“the Act”).

The GFSC is responsible for the following statutory objectives:

- a) The promotion of market confidence;
- b) The reduction of systemic risk;
- c) The promotion of public awareness;
- d) The protection of the good reputation of Gibraltar;
- e) The protection of consumers; and
- f) The reduction of financial crime

Our regulation of Statutory Auditors touches upon all of the above objectives to varying degrees.

A statutory audit is a legally required review of financial records. The purpose of a statutory audit is to certify the financial statements of companies or public entities. An audit provides stakeholders such as investors and shareholders with an opinion on the accuracy of companies’ accounts. As a result, statutory audits contribute to the orderly functioning of markets by improving the confidence in the integrity of financial statements.

Whilst the primary responsibility for delivering financial information should rest with the management of the audited entities, statutory auditors and audit firms play an important role in providing their independent opinion of the financial statements.

Statutory auditors are required to follow certain accounting and auditing standards as well as ethical requirements. When it comes to the regulation of Statutory Auditors the prime focus is on audit quality.

In order to improve audit quality, it is therefore important that the professional scepticism exercised by statutory auditors and audit firms in relation to the audited entity be reinforced. Statutory auditors and audit firms should recognise the possibility that a material misstatement due to fraud or error could exist, notwithstanding the auditor's past experience of the honesty and integrity of the audited entity's management.

We monitor audit quality by carrying out a system of quality assurance visits.

We are required to publish the overall results of the quality assurance visits annually and these results are included in this report.

Audit Regulation

We successfully implemented the required amendments from the Audit Directive (2014/56/EU) to the Act before the 17th June 2016 deadline.

Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities (“Audit Regulation”) also came into effect on 17 June 2016.

In addition to the existing report on the overall results of the quality assurance system, the Audit Regulation requires the competent authorities to issue the following publications:

- An annual activity report;
- An annual work programme;
- The aggregated information on the findings and conclusions of inspections*

* This has been provided in previous years as part of the overall results of the quality assurance visits.

This Annual Report of Audit Supervision is intended to capture the above requirements of the Audit Regulation and communicate our regulatory activity of statutory auditors.

Annual activity report

Monitoring market quality and competition

On the 17 June 2016, the GFSC provided to several European Bodies a report on developments in the market for providing statutory audit services to public-interest entities under Article 27(1) of the Audit Regulation. This included the Committee of European Auditing Oversight Bodies, the European Securities and Markets Authority, the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Commission.

The report on monitoring market quality and competition centred on four key areas:

1. Risks arising from high incidence of quality deficiencies of a statutory auditor or an audit firm
2. Market concentration levels
3. The performance of audit committees
4. The need to adopt measures to mitigate risks arising from high incidence of quality deficiencies of a statutory auditor or an audit firm

Meeting with Industry Bodies

The GFSC met quarterly with the Gibraltar Society of Accountants during the past year. These meetings are intended to facilitate dialogue on general non-firm specific matters of audit regulation. In addition to this, the forum is used to discuss matters of mutual interest between financial services firms and auditors.

Quality Assurance Reviews

As at 31 March 2017 we completed the final year of a 4-year cycle and had reviewed all the firms and individuals which existed at the start of the cycle and continued to be licensed. There were a small number of practitioners who were licensed during the review cycle and these were rolled forward to the next cycle of visits commencing 1 April 2017. Practitioners who had not yet received a Quality Assurance visit will be visited within the 6-year statutory time period from the date their licence was granted.

Auditors Annual Returns

The GFSC continues to make use of an annual return to collect key relevant information on statutory auditors and audit firms. The information is used to assist us in our risk assessment, confirms compliance with required standards and requirements and ensures the accuracy of our internal and external databases.

The GFSC is working on updating the returns for the majority of its licensees, including statutory auditors and audit firms. This is intended to replace the existing return and make it more 'future proof'. It will include further information required as part of compliance with the Audit Regulation and will also make the information easier to capture and analyse.

Annual work programme

Overview

The quality assurance reviews are the equivalent of the risk assessment carried out for other sectors that the GFSC regulates and supervises. These reviews do not follow the standard risk assessment process of the GFSC as the approach and scope towards assessing Auditors is very different. They are carried out through an assessment of the internal quality control system of the Auditor, supported by adequate testing of selected audit files, and work towards ensuring high quality audits within Gibraltar.

The team continued to work closely with the Institute of Chartered Accountants in England and Wales (ICAEW) to perform a programme of inspections.

The quality assurance reviews focus on assessing compliance with the regulatory framework for auditing in Gibraltar, including compliance with Auditing Standards, the International Standard on Quality Control 1 (ISQC1) and the International Ethics Standards Board for Accountants (IESBA) code of Ethics.

2016 /2017

A total of 4 firms were visited during the year in review. All of these visits took place prior to 17 June 2016 and were therefore conducted under the regime that was in place prior to the enactment of the Audit Regulation and revised Audit Directive.

2017 /2018 plan

We aim to visit 3 Audit firms during the coming year ahead.

This is the first year where the Audit Regulation is applicable and for Quality Assurance visits Insurance companies and Credit Institutions are now both defined as Public Interest Entities (“PIEs”), in addition to fully listed companies. With the widening of the scope for PIEs this has also increased the number of Audit Firms which must be subject to a Quality Assurance visit at least once every 3 years.

Results of the Quality Assurance System

A total of 4 licensed firms were visited between 1 April 2016 and 31 March 2017 as part of our system of Quality Assurance review visits.

Recommendations issued

We identified areas for improvement, including in some cases the quality of audit evidence, on all of the files we reviewed.

The recommendations issued focused on addressing the findings of the inspections. These are summarised later on in the report.

Follow-up on the recommendations

The firms have set out comprehensive and suitable action plans to address the matters we identified.

The recommendations for matters to be addressed are set out in a closing record. This is provided to the firm at the end of the visit, with an opportunity for the firm to provide its comments and discuss these at a closing meeting.

The closing record forms the basis of a final report which will consider the results of the visit together with the firm's final comments.

The firms then have an opportunity to consider whether the report is factually correct prior to final consideration by the GFSC.

All firms are then reminded of their requirement to fulfil the undertakings and confirmations as stated in the closing record and the final report.

Additionally, in respect of two audit firms a specific deadline was set, providing them an opportunity to implement the recommendations and rectify the significant findings observed.

Supervisory measures taken

None were taken as a result of the Quality Assurance System.

Sanctions imposed

None were imposed as a result of the Quality Assurance System.

Key performance indicators

No quantitative information and other key performance indicators on financial resources and staffing and the efficiency and effectiveness of the quality assurance system is currently collected. This, however, will be considered for future reports.

Findings and conclusions of inspections

Audit quality was found to be generally satisfactory with no materially significant concerns.

Our key findings and concerns identified during the audit inspections carried out during the year ended 31 March 2017 are set out below:

Audit Procedures, Evidence and Documentation

The reviews focused on the sufficiency and appropriateness of the audit procedures, evidence and the quality of documentation to support the judgements made in reaching the audit opinions. This was satisfactory in most instances, but some examples of areas for improvement noted on individual files were:

- The requirement of identifying the risk of management override of controls as a significant risk.
- Treatment of an unadjusted item where materiality had changed during the course of the audit.
- Appropriate approach for scope limitation on clients.
- Documenting walk-throughs to confirm the implementation of controls.
- Substantive analytical review not being sufficiently robust to provide the necessary audit evidence.

Engagement Performance

We identified some other aspects of audit work that required improvement, including demonstrating appropriate engagement partner involvement in some cases.

Ethics and Independence

Auditors need to consider the independence on each audit engagement and ensure appropriate safeguards are implemented in accordance with the IESBA Code of Ethics. Generally, no significant threats were found in this area. There was however an example where a firm needed to demonstrate stronger acceptance and continuance procedures to demonstrate the independence of another network firm used, its personnel involved in the audit and their competence.

Monitoring

Where monitoring was concerned, the approach taken was found to be falling short of the level expected from an audit firm in different aspects of ISQC1 including the frequency of internal reviews. The firms have confirmed that these will subsequently be addressed.

Training and development

On some visits we observed that although appraisals were being conducting for audit staff members, this did not always include the partners or directors of the audit firm. A formal partner appraisal process in place will assist in giving audit quality further prominence as well as helping to embed a strong culture of ownership and responsibility.

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