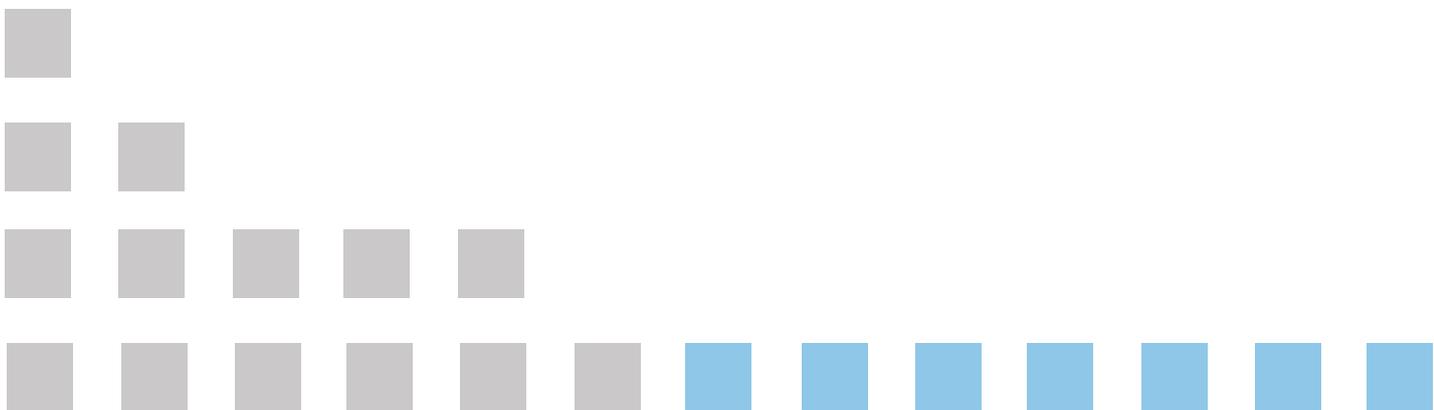


Annual Report on Audit Supervision

2017 - 2018



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 independent opinion on 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 rests 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.

Governance arrangements

In accordance with section 6A of the Financial Services Commission Act 2007, the Financial Services Commission arranges for its functions as the competent authority to be exercised by its Auditors Regulatory Committee (“ARC”).

The current composition of the ARC is made up as follows:

- Dr Jonathan Spencer
- Emma Perez
- Bruno Callaghan
- Adrian Coles
- Paul Sharma
- Peter Isola

The Committee comprises of a senior member of the GFSC management team and not more than six Members of the Board of the Commission. The Committee must consist of members who are not practicing auditors and who do not otherwise fall within paragraph 3 of Article 21 of the Audit Regulation.

As from 14 June 2018, Samantha Barrass ceased to be a member of the ARC.

Annual activity report

Meeting with Auditors of Banks and Insurance Companies

The GFSC met with the auditors of insurance companies between April and May 2017. The meetings were arranged as per the EIOPA guidelines on facilitating an effective dialogue between competent authorities supervising insurance undertakings and statutory auditors and the audit firms carrying out the statutory audit of those undertakings. A further set of meetings took place between January and February 2018, this also covered the banking audits under the EBA guidelines on the communication between competent authorities supervising credit institutions and statutory auditors of those institutions.

These meetings discussed:

- Current and emerging risks identified for the industry
- Discussion on firm specific risks
- Requirements of EU regulation 537/2014 (“Audit Regulation”) regarding requirements of statutory auditors of public-interest entities

Quality Assurance Reviews

On the 1 April 2017 we began a new cycle of Quality Assurance reviews. This was the first year where the Audit Regulation is applicable where 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 increased the number of Audit Firms which must be subject to a Quality Assurance visit at least once every 3 years.

Non-PIE auditors are required to have a Quality Assurance review undertaken at least once every 6 years.

It should be noted that a sample of non-PIE audits are also selected for review when performing inspections of Audit Firms who audit PIEs.

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.

Transparency reports

A statutory auditor or an audit firm that carries out statutory audits of PIEs shall make public an annual transparency report at the latest four months after the end of each financial year. With the widening of the definition of PIEs a greater number of audit firms are now required to prepare and publish a Transparency report. This became effective for audit firms with year-ends commencing on or after 17 June 2016.

The GFSC has been reviewing the transparency reports published in order to ensure firms are complying with the requirements as set out in the Audit Regulation.

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.

2017 /2018

A total of 3 firms were visited during the year in review. The results of the inspections together with the findings and conclusions are set out in the subsequent pages.

2018 /2019 plan

We aim to visit 4 Audit firms during the coming year.

This is the second year of the 3-year cycle for PIE auditors. We also plan to review a non-PIE auditor. This visit falls due under the 6-year period as set out in the Financial Services (Auditors) Act 2009.

Findings and conclusions of inspections

Audit quality was found to be generally satisfactory. Some isolated areas for improvement were identified in some cases, but there were no thematic issues identified.

Our key findings identified during the audit inspections carried out during the year ended 31 March 2018 are set out below:

Audit Procedures, Evidence and Documentation

The reviews focused on the sufficiency and appropriateness of the audit procedures, audit evidence and the quality of documentation for selected areas to support the key 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:

- Substantive analytical review not being sufficiently robust to provide the necessary audit evidence.
- Work done around the capitalisation and expenditure split of intangibles.
- Incomplete disclosure of related party transactions in financial statements.
- Insufficient documentation of work done to support key judgements on the adequacy of provisions.
- Weakness in evidence obtained in the assessment of the going concern basis.

Additional procedures required for PIEs

- During the inspections we observed an audit firm had not prepared an extended audit report as required by ISA 701. This was the first audit completed by the firm where the requirement applied and the audit report was reissued after our inspection.
- Another finding observed related to an audit firm who did not include all the information required for PIE entities (ISA 260 and Audit Regulation) in their report to those charged with governance.

Ethics and Independence

Generally, no significant issues were found in this area. There was however an example where an audit firm's connected entity provided secretarial and nominee shareholder services to a few audit clients. The role of a company secretary is seen to imply a close degree of association with the entity and may create self-review and advocacy threats. The International Ethics Standards Board for Accountants ("IESBA") code of ethics also prohibits holding financial interests, however noting that in a nominee capacity the holding would be non-beneficial. The perception of the firm's independence was therefore under threat. The connected entity subsequently ceased providing these services to the audit clients of the firm.

While no significant issues were identified from the inspections in the current year, we did highlight the need to carefully monitor the more stringent requirements for the audit of PIEs.

Monitoring

Where monitoring was concerned, we observed an instance where detailed documentation for cold file reviews was not being retained therefore were not able to be reviewed during our inspection. Summarised findings of the cold file reviews were also not specific enough for the inspection team to analyse these properly. Cold file reviews are important in monitoring and improving audit quality.

Results of the Quality Assurance System

A total of 3 licensed firms were visited between 1 April 2017 and 31 March 2018 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. We categorised findings as significant or less significant. Four files out of a total of nine reviewed did not have any significant findings.

The recommendations issued focused on addressing the findings of the inspections. These are summarised in the previous section.

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 and our consideration of the adequacy of the firm's action plan.

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 one audit firm, an undertaking was provided that it would cease certain non-audit services before the next audits were carried out.

Supervisory measures taken

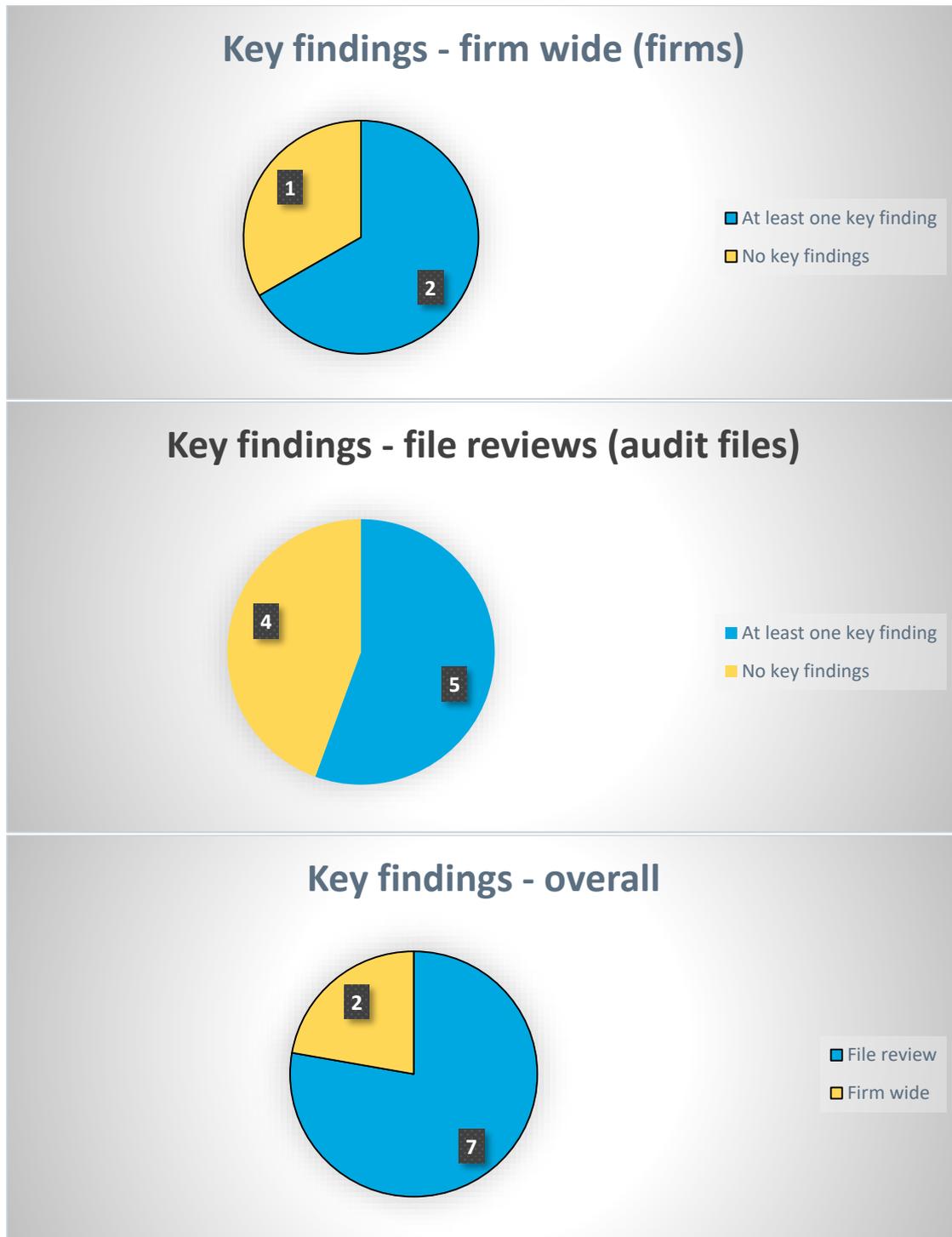
None were taken as a result of the Quality Assurance System.

Sanctions imposed

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

Key performance indicators

3 Quality Assurance Reviews conducted.



There is **1** full time inspector allocated for quality assurance reviews. ICAEW provide technical support and training during the year.

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