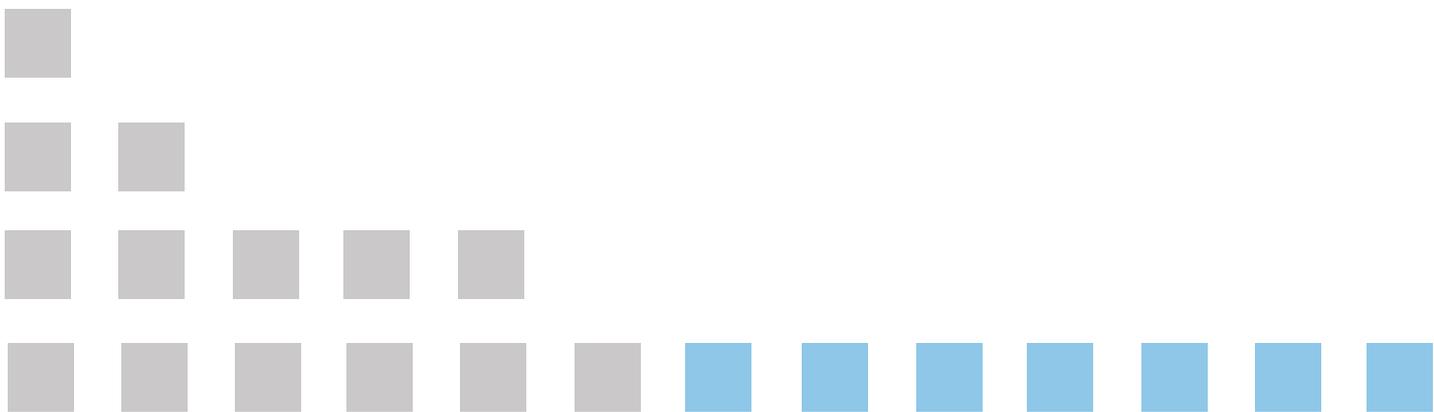


Annual Report on Audit Supervision

2018 - 2019



Introduction

The Gibraltar Financial Services Commission (GFSC) is the competent authority for statutory auditors conducting statutory audits in Gibraltar as designated in the Financial Services (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

All of our objectives are relevant to our regulation of statutory auditors.

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 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 programme 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

The Auditors Regulatory Committee (ARC) acts as the governing body in discharging the functions and duties of the GFSC as the competent authority for statutory auditors.

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

- Dr Jonathan Spencer
- Kerry Blight
- Emilio Gomez
- Adrian Coles
- Paul Sharma
- Peter Isola

The Committee must consist of members who are not practicing auditors and who do not otherwise fall within paragraph 3 of Article 21 of EU Regulation 537/2014.

The Director of Audit Regulation, Kathryn Morgan, is responsible for reporting the regulation of statutory auditors to the committee.

Annual activity report

Meeting with Auditors of Insurance Companies and Banks

The GFSC met with the auditors of insurance companies between October and November 2018. The meetings were arranged in line with the EIOPA and EBA guidelines on facilitating an effective dialogue between competent authorities supervising insurance firms and banks, and statutory auditors and the audit firms carrying out the statutory audit of those firms.

These meetings discussed:

- Current areas of focus on improving audit quality
- Current and emerging risks identified for the industry
- Discussion on firm specific risks
- Recent generic, banking and insurance audit training conducted.

Quality assurance reviews

On 1 April 2018 we continued our cycle of quality assurance reviews. This was the second year where insurance firms and banks 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 three years.

Non-PIE auditors are required to have a quality assurance review undertaken at least once every six 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 ensures the accuracy of data and information on our internal and external databases.

Transparency reports

Statutory auditors or audit firms that carry out statutory audits of PIEs are required to publish an annual transparency report during the last 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 this report. This requirement became effective for audit firms with year-ends commencing on or after 17 June 2016.

The GFSC has reviewed transparency reports in order to ensure firms have complied with the requirements as set out in EU Regulation 537/2014.

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.

We 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.

2018 /2019

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

2018 /2019 plan

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

This is the third year of the three-year cycle for PIE auditors. We also plan to review a number of non-PIE auditors. These visits fall due under the six-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 common issues identified.

Our key findings identified during the audit inspections carried out during the year ending 31 March 2019 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:

- Group materiality incorrectly being applied to sample sizes for an individual entity.
- Work being done on the year-end valuations but not on material movements during the year.
- Insufficient consideration of the reliability and accuracy of system generated reports.
- Insufficient audit evidence for premium income and claims in insurance audits.
- Weakness in evidence obtained and a lack of robust challenge in the assessment of the going-concern basis.
- Insufficient work done to support the valuation of a material deferred tax asset.
- Further work required on intercompany confirmations when these are provided by the same person for both companies.
- In respect of a group audit, the group auditor should have determined the strategy and scope of the group audit, including group-wide risk assessment and identification of significant components.
- Also for a group audit, the audit file did not provide sufficient detail to determine how the firm had confirmed the adequacy of testing significant components of the group.

Additional procedures required for PIEs

- We noted for one firm that there was insufficient documentation of the nature and extent of the engagement quality control review.
- In one case the transparency report was done at network/regional level and did not include information specific to the Gibraltar entity.

Ethics and Independence

No significant issues were found in this area.

Monitoring and other ISQC1 matters

We observed an instance where a firm's cold file reviews were ineffective in picking up issues and deficiencies within the audits selected. Cold file reviews are important in monitoring and improving audit quality.

During our inspection we found an example where ISQC1 compliance matters were kept at network/regional level and not at the Gibraltar entity.

Results of the quality assurance programme

A total of 4 licensed firms were visited between 1 April 2018 and 31 March 2019 as part of our system of quality assurance review visits.

Recommendations issued

We identified areas for improvement, including in some cases relating to the quality of audit evidence, on all of the files we reviewed. We categorised findings as significant or less significant. Six files out of a total of eleven reviewed did not have any significant findings.

The recommendations issued focused on addressing the findings of the inspections.

Follow-up on the recommendations

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 onsite, with an opportunity 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.

We then ensure that firms set out comprehensive and suitable action plans to address our recommendations. These action plans are then monitored by the GFSC.

Supervisory measures taken

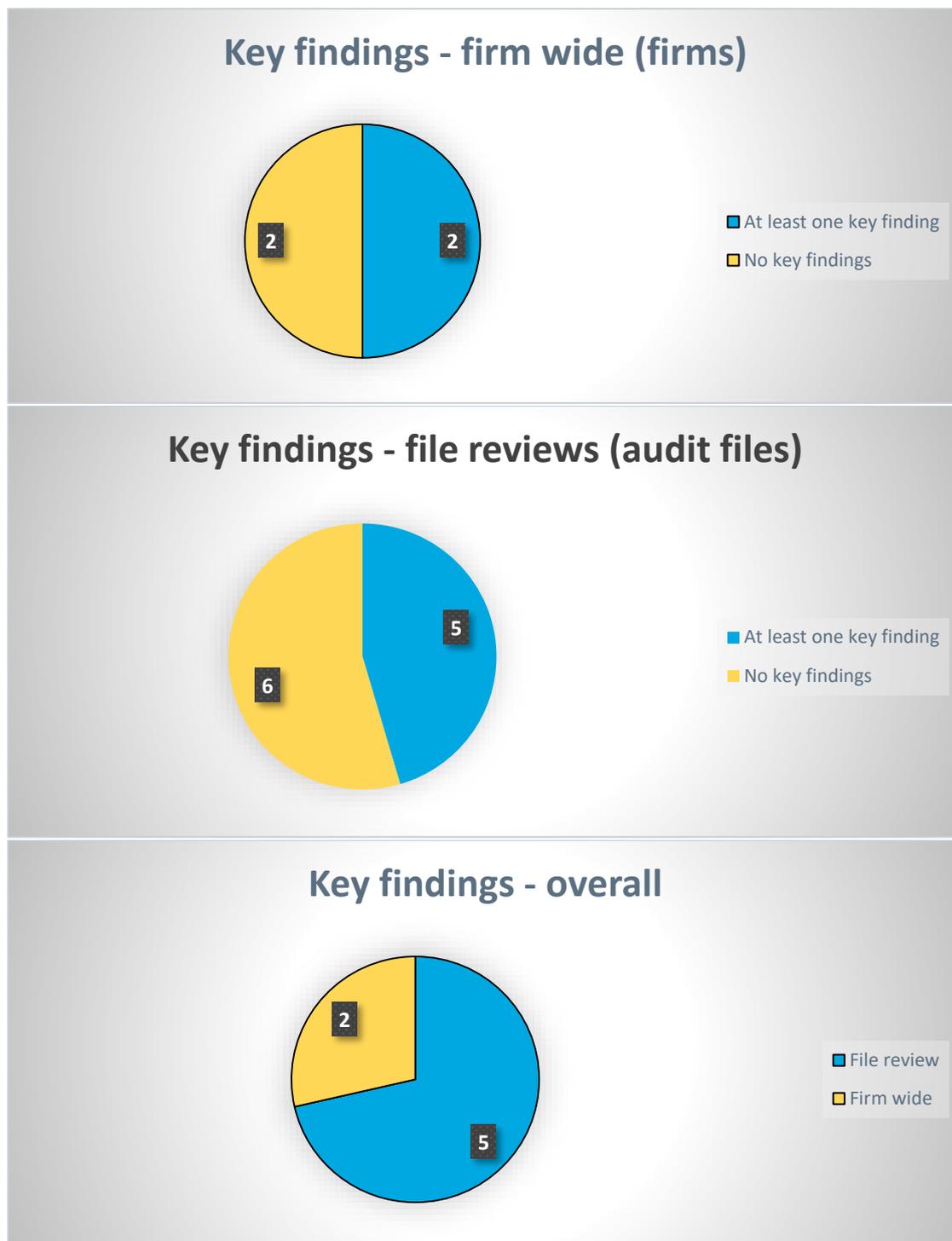
No formal measures were taken as a result of the quality assurance programme.

Sanctions imposed

None were imposed as a result of the quality assurance programme.

Key performance indicators

Four quality assurance reviews were conducted.



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