

# Banking Newsletter

Number 6 Year 1997



**Financial Services  
Commission**

## Guidance Note On Reporting Accountants Regime

1. As part of the process of matching UK standards in banking supervision, the Commissioner of Banking has introduced a Reporting Accountants Regime to help him satisfy himself on the adequacy of licensed banks' systems and controls and on the accuracy of the returns which they submit monthly or quarterly under the Banking Ordinance. This regime is modelled on that used since 1988 by the Bank of England.
2. This regime applies to all licensed banks. It does not in normal circumstances apply to Gibraltar branches of banks incorporated in the United Kingdom or in other EEA states. However, it is possible that the Commissioner may need on rare occasions to commission reports from such branches for supervisory reasons, probably in consultation with their home supervisors.

### Appointment of Reporting Accountants

3. Each licensed bank is required to appoint a firm of Reporting Accountants (RA). In the case of a locally-incorporated bank this should normally be the external auditor which it has appointed under section 44 of the Banking Ordinance. Branches of banks with head offices outside the EEA are normally expected to appoint a Gibraltar firm of accountants but this is discussed on a bilateral basis with the small number of such banks.
4. From time to time, however, there may be specific cases where the Commissioner decides to instruct a bank to appoint a RA which is not its external auditor. This may be done, for example, where there are questions over the independence or objectivity of the external auditor or where the subject of the review of controls to be undertaken is such that particular expertise possessed by another firm is required. This power is likely to be used rarely, especially during the regime's early years.
5. The Commissioner uses his powers under the Banking Ordinance to request each licensed bank to commission from its RA two different annual reports; these are discussed in paras 11-16 and 17-19 respectively below. The RA reports to the bank's management, who meet all the costs of this exercise. Management then add its comments, including where appropriate details of any remedial measures being taken, and forwards copies of the RA's reports to the Commissioner.

### Annual statement from RAs and directors

6. Annual written confirmation is required from RAs that nothing has come to their attention in the ordinary course of their work which gave them reasonable cause to believe that a material breach of the licensing criteria had occurred
7. The Commissioner has also decided in principle to require at about the same time each year a written declaration from the bank's board of directors (or in the case of a branch its appointed designate) that the bank (or branch):



- is in compliance (subject to exceptions if appropriate) with the minimum criteria for licensing under the Banking Ordinance, namely sub-sections (1) and (3) of section 23; and
  - has systems in place to monitor and control adequately its material risks and these systems are being properly applied.
8. This declaration will only make explicit responsibilities which banks and their boards should already be fulfilling. A form of words will be provided when further work on the responsibilities of directors of banks has been completed in the UK and Gibraltar. From time to time a bank's RA may be asked to review the process which the board (or its appointed designate) has used to provide the confirmation relating to the fulfilment of the criteria for licensing.

## Trilateral meetings

9. The Commissioner or Banking Supervisor, as appropriate, holds an annual "trilateral" meeting with each bank's management and RA to discuss the two reports and, in the case of locally-incorporated banks, the management letter produced after the annual audit. A timetable for any follow-up action is also agreed. Around the time of this meeting the Commissioner or Banking Supervisor contacts the RA by telephone so that he is given an opportunity to raise any points which he may not want to raise with management present.
10. The Commissioner reserves the right to hold a separate bilateral meeting with a bank's RA if, for example, either party has concerns about possible breaches of the licensing criteria, especially where these relate to senior management or the board. The bank is normally informed of such bilateral meetings.

## Reports on accounting and other records and internal control systems

11. One of the criteria for licensing which banks must continue to fulfil is section 23(3)(h) of the Banking Ordinance, i.e. at all times to maintain adequate accounting and other records of the business and adequate systems of control of the business and records. The Commissioner has recently issued Banking Newsletter Number 5 of 1997 on his interpretation of the Ordinance's requirements in relation to records and systems, both to assist licensed banks in assessing whether they satisfy those requirements and to help RAs to report on banks' records and systems.
12. The Commissioner normally requires each licensed bank to commission one report a year from its RA on the adequacy of accounting records and systems and controls, including controls against money laundering. The notice setting out what aspects of these are to be examined is normally issued at least three months before the end of each bank's financial year so that the work can be done as part of the annual audit. The Commissioner may, however, also commission a report on other occasions, for example where there has been a major change in the business or where significant action has been required to remedy previously-identified weaknesses.
13. The scope of the reports requested takes account of each bank's risk profile, control environment and size. The cost implications for banks are also taken into account but not at the expense of supervisory considerations. The Banking Supervisor has decided what scope should be set for the initial report but in subsequent years the scope of future reports will also be discussed at each trilateral meeting.



14. The RA's report is addressed to the bank's directors or, in the case of a branch, its manager, and it should follow a proforma, a draft of which is set out in Annex 1 to this newsletter.

15. The RA is required to give an overall assessment of the control environment for each business area they have been asked to examine and, unless exempted in the commissioning notice, should provide some background information on the nature and approximate volume of transactions, the key risks faced by the bank and the key controls in operation, plus an outline of the work undertaken to produce the report. Where the report is qualified by exception, it should clearly set out the risks which the bank runs by not correcting the weakness(es). RAs are not required to report all weaknesses in systems and controls, only those which individually or collectively do not enable them to give reasonable assurance that the Ordinance's requirements have been met.

### Timetable

16. In normal circumstances these reports should be submitted to the Commissioner within four months of the end of each bank's financial year accompanied by management's comments.

### Reports on Banking Ordinance returns

17. The Commissioner issues notices to all licensed banks once a year requiring them to commission their RAs to report on a specific Banking Ordinance return - or returns - already submitted to the Banking Supervisor. An initialled copy of the return to be reported on is enclosed with the notice. (If the Banking Supervisor has agreed with a particular bank to receive prudential information in addition to the usual returns, this may be made the subject of a report.) Management are asked to submit the report to the Commissioner with their comments (if any) and it is discussed during the trilateral meeting described in the previous section of this paper.

18. The Commissioner issues these notices at least three months before the end of each bank's financial year so that the work can be done as part of the annual audit. In normal circumstances a deadline is set of four months for their submission to the Commissioner accompanied by management's comments (if any). A draft of the form of words to be used is attached as Annex 2 to this note.

### Timetable

19. The Commissioner introduced these annual reports on Banking Ordinance returns with effect from bank's financial years ending on or after 30 September 1997. The Commissioner will shortly issue guidance on the completion of the new reporting returns being introduced in 1998.

### Offences under Section 82 of the Banking Ordinance

20. Within the context of the Reporting Accountants Regime the managers of licensed banks and RAs should be aware of section 82(6) of the Banking Ordinance which makes it an offence wilfully to make any statement which is known to be untrue in any material respect in supplying information to the Commissioner for the purposes of the Ordinance. Other parts of Section 82 may also be relevant in some circumstances.



## Annex 1

### REPORTING ACCOUNTANTS' REPORT ON ACCOUNTING AND OTHER RECORDS AND INTERNAL CONTROL SYSTEMS

THE DIRECTORS, XYZ BANK LIMITED

THE MANAGER, ABC BRANCH

Dear Sir(s)

In accordance with your letter of instruction dated [ ], a copy of which is attached, we have examined the accounting and other records and internal control systems in certain areas of [name of bank] which were in existence during the [year/period] ended [ ]. The areas examined comprised [ ].

Appendix 1 to this report summarises the key risks faced by the bank, the key controls in place and our overall assessment of the control environment which the bank relies on for each business area we were required to examine in accordance with your letter of instruction dated [ ]. Appendix 2 gives an outline of the organisational structure of the bank together with a brief description of the nature and approximate volume of transactions entered into by the bank in the areas examined. Appendix 3 gives an outline of the work we undertook together with an indication of the level of testing of the key controls, as identified in Appendix 1, which we carried out.

Respective responsibilities of [directors/manager], reporting accountants and the Commissioner of Banking.

As [directors/manager] of [name of bank] you are responsible for establishing and maintaining adequate accounting and internal control systems. In fulfilling that responsibility, estimates and judgments must be made to assess the expected benefits and relative costs of management information and of control procedures. The objective is to provide reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorised use or disposition, that banking and market risks are properly monitored and evaluated, that transactions are executed in accordance with established authorisation procedures and are recorded properly, and to enable you to conduct the business in a prudent manner.

It is our responsibility to form an independent opinion, based on our examination, on the accounting and other records and internal control systems in the specified areas and to report our opinion to you. We are required to report those exceptions which, individually or collectively, are in our opinion, significant and result in there not being reasonable assurance that the requirements set out in the Banking Newsletter 5 of 1997 ("the guidance note") are satisfied.

It is the Commissioner of Banking's responsibility to judge, in the light of the contents of this report and other information about [name of bank] which is available to him, whether [name of bank] meets the licensing requirements of section 23 of the Banking Ordinance 1992 as regards records and systems.

Because of inherent limitations in any accounting and internal control system, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the systems to future periods is subject to the risk that management information and control procedures may become inadequate because of changes in the conditions or that the degree of compliance with those procedures may deteriorate.



### **Basis of opinion**

Our examination has been carried out having regard to the guidance note, and to the Practice Note: Banks in the United Kingdom issued by the Auditing Practices Board. Such an examination includes an assessment of the nature of the accounting and other records and of the design of the internal control systems, together with testing of these records and controls on a sample basis.

### **Opinion**

EITHER

[Except for the matters set out in Appendix 4 to this report,] in our opinion, having regard to the nature and scale of [name of bank]'s business, during the [year/period] ended [ ], the accounting and other records and internal control systems in the areas examined by us were established and maintained in accordance with the requirements of the guidance note.

OR

For the reasons set out in Appendix 4 to this report, in our opinion, having regard to the nature and scale of [name of bank]'s business, during the [year/period] ended [ ], the accounting and other records and internal control systems in the areas examined by us were not established and maintained in accordance with the guidance note.

Yours faithfully

A Reporting Accountant  
Chartered Accountants.



## Annex 2

### REPORTING ACCOUNTANTS' REPORT ON BANKING ORDINANCE RETURNS

THE DIRECTORS, XYZ BANK LIMITED  
THE MANAGER, ABC BRANCH

Dear Sir(s)

In accordance with your letter of instruction dated [ ], a copy of which is attached, we have examined those returns referred to which you have submitted to the Banking Supervisor. We attach a copy of the returns, which we have initialed for the purpose of identification.

Appendix 1 to this report gives an outline of the work we undertook to meet the requirements of the letter of instruction.

Respective responsibilities of [directors/manager] and reporting accountants

As [directors/manager] of [name of bank], you are responsible for the preparation and submission of the returns and for ensuring that the information therein:

- has been completely and accurately extracted from the accounting and other records; and
- has been prepared and presented:
- in accordance with the current reporting instructions [and specific written rulings issued by the Banking Supervisor] ; [and
- using the same accounting policies as those applied in the most recent statutory accounts] .

It is our responsibility to form an independent opinion, based on our examination, on the returns and to report our opinion to you.

#### **Basis of opinion**

Our examination has been carried out having regard to Banking Newsletter 5 of 1997 and in accordance with the Auditing Practice Note: Banks in the United Kingdom issued by the Auditing Practices Board. Such an examination includes testing, on a sample basis, the extraction from the records of the amounts and classification of items reported in the returns. [It also includes a comparison of the accounting policies used to prepare the returns with those applied in the most recent financial statements.]<sup>1</sup> It does not include an examination of the completeness and accuracy of the information contained in the underlying accounting and other records.

#### **Opinion**

EITHER

[Except for the matters set out in Appendix 2 attached to this report,] in our opinion, in all material respects, the information contained in the [specify the returns] returns examined by us has been completely and accurately extracted from the accounting and other records and has been prepared and presented



in accordance with the current reporting instructions [and specific written rulings]<sup>2</sup> issued by the Commissioner of Banking [and using the same accounting policies as those applied in the most recent statutory accounts]<sup>1</sup>.

OR

For the reasons set out in Appendix 2 attached to this report, in our opinion, in all material respects, the information contained in the [specify returns] returns examined by us has not been completely and accurately extracted from the accounting and other records and has not been prepared and presented in accordance with the current reporting instructions [and specific written rulings]<sup>2</sup> issued by the Commissioner of Banking [and using the same accounting policies as those applied in the most recent statutory accounts]<sup>1</sup>.

Yours faithfully

A Reporting Accountant  
Chartered Accountants

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