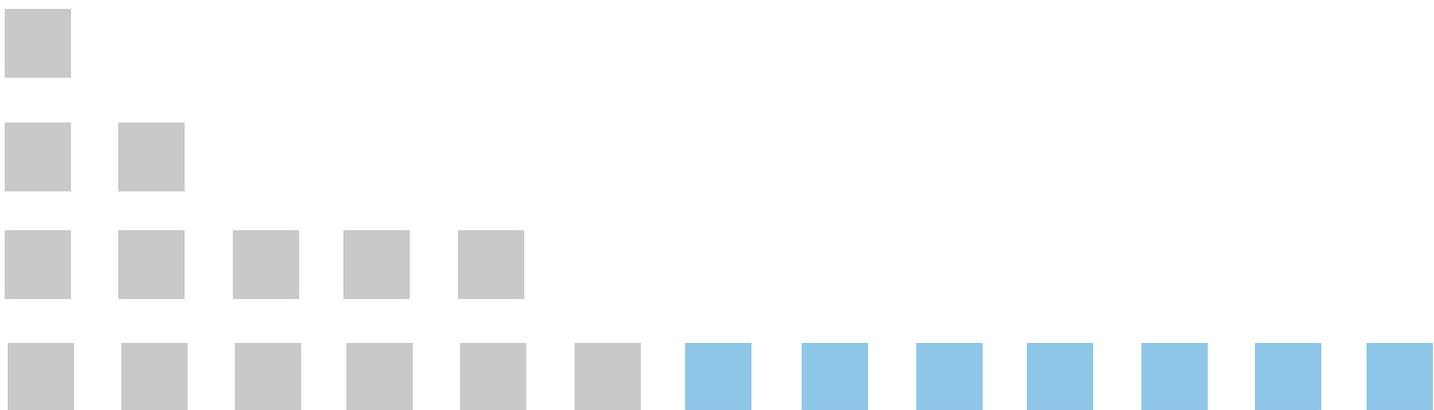


Annual Report on Audit Supervision

2019 - 2020



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 Act 2019 (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 these objectives are relevant to the GFSC's 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 experience of the honesty and integrity of the audited entity's management.

The GFSC monitor audit quality by carrying out a programme of quality assurance visits.

The GFSC is 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 composition of the ARC as at 31 March:

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

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 GFSC's Director of Specialist Regulation, Heidi Bocarisa, 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 and banks during November 2019. 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.

The meetings discussed:

- The GFSC's current and emerging risks identified for the industries
- Auditor's view on current and emerging risks and identification of any further risks
- Discussion on insurance and banking firms' specific risks

Quality assurance reviews

On the 1 April 2019, the GFSC continued its cycle of quality assurance reviews. This was the third year where insurance firms and banks were included within the definition of 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 that 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.

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. This information is used to assist the GFSC in its risk assessment, confirms compliance with required standards and ensures the accuracy of data and information in the GFSC's 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 four months after their year-end. With the widening of the definition of PIEs, a greater number of audit firms are now required to prepare and publish 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. These 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 GFSC 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.

2019 /2020

A total of six firms were visited during the year in review. The results of the inspections together with the findings and conclusions are set out below. These included a number of non-PIE auditors.

2020 /2021 plan

The GFSC aims to visit four audit firms during the coming year.

This is the start of the next three-year cycle for PIE auditor inspections.

Findings and conclusions of inspections 2019/2020

Audit quality was found to be generally satisfactory. Some isolated areas for improvement were identified in a number of cases, but there were no common issues identified.

Key findings identified during the audit inspections carried out during the year ending 31 March 2020 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 mixed in most instances, with no specific themes emerging. Some specific examples of significant areas for improvement are noted below:

Planning

- Opening balances not tested in a first year audit.
- Preliminary and final analytical review not undertaken.
- Documented risk assessment not an accurate reflection of the actual considered risks.
- No discussion held with the client at either the planning and completion stages.
- Risks of fraudulent revenue recognition or management override not fed into audit work programmes.
- Walkthroughs or similar not carried out on systems of control.

Group

- Documentation of work done by component auditors on a group audit was not sufficient.
- The instructions to component auditors were not particularly tailored towards the needs of the audit and vice-versa. The reporting from the component auditor did not reflect procedures that had been required by the instructions.
- Assessment of the competency, independence and ability of component auditors not present on file.
- No contract, agreement of terms or engagement letter with component auditors.

Testing

- It was not clear from the audit file why an accounting policy on the recognition of an asset and a liability was deemed appropriate.

- Limited evidence on audit file to support the assumptions used in the valuation of an investment property. The integrity, ability and independence of the expert providing the valuation was not assessed and documented.
- Insufficient evidence of directing and controlling a subcontractor’s audit work.

Insurance (PIE)

- Insufficient audit testing carried out on claims outstanding balances.
- Insufficient evidence of the evaluation of source data provided to the management’s expert (Actuary), challenge of the assumptions used and follow up of matters identified.

Conclusion

- Weakness in evidence obtained and a lack of robust challenge in the assessment of the going-concern basis.
- Insufficient work done on journal testing.
- Insufficient audit work conducted in order to meet a filing deadline.
- No work conducted on whether the client was complying with laws and regulations, or consideration of potential litigation and claims.

Additional procedures required for PIEs

- Client became PIE during its year-end and the audit firm did not appoint an Engagement Quality Control Reviewer (EQCR) to the engagement.
- An audit firm had not completed a transparency report within four months of its year-end.
- A succession plan in respect of a PIE audit was not in place.

Ethics and Independence

Two firms had not obtained fit and proper and independence forms from a number of members of the audit team.

Monitoring and other ISQC1 matters

A firm had not carried out a whole firm review. External cold file reviews had been performed, but arrangements were not in place to ensure that these come to pass annually.

A further firm did not have an internal monitoring process that ensured annual coverage of all statutory auditors.

In one circumstance a statutory auditor who was not actively involved in audit work had not taken part in appropriate programmes of continuing education in order to maintain his theoretical knowledge, professional skills and values at sufficiently high level.

Results of the quality assurance programme

Six licensed firms were visited between 1 April 2019 and 31 March 2020 as part of the GFSC's system of quality assurance review visits.

Recommendations issued

The GFSC identified areas for improvement, including in some cases relating to the quality of audit evidence, on all of the files reviewed. The GFSC categorised findings as significant or less significant. Only two files out of a total of thirteen 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 that will consider the results of the visit together with the firm's final comments and the GFSC's 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.

The GFSC then ensures that firms set out comprehensive and suitable action plans to address its recommendations. These action plans are then monitored by the GFSC.

Supervisory measures taken

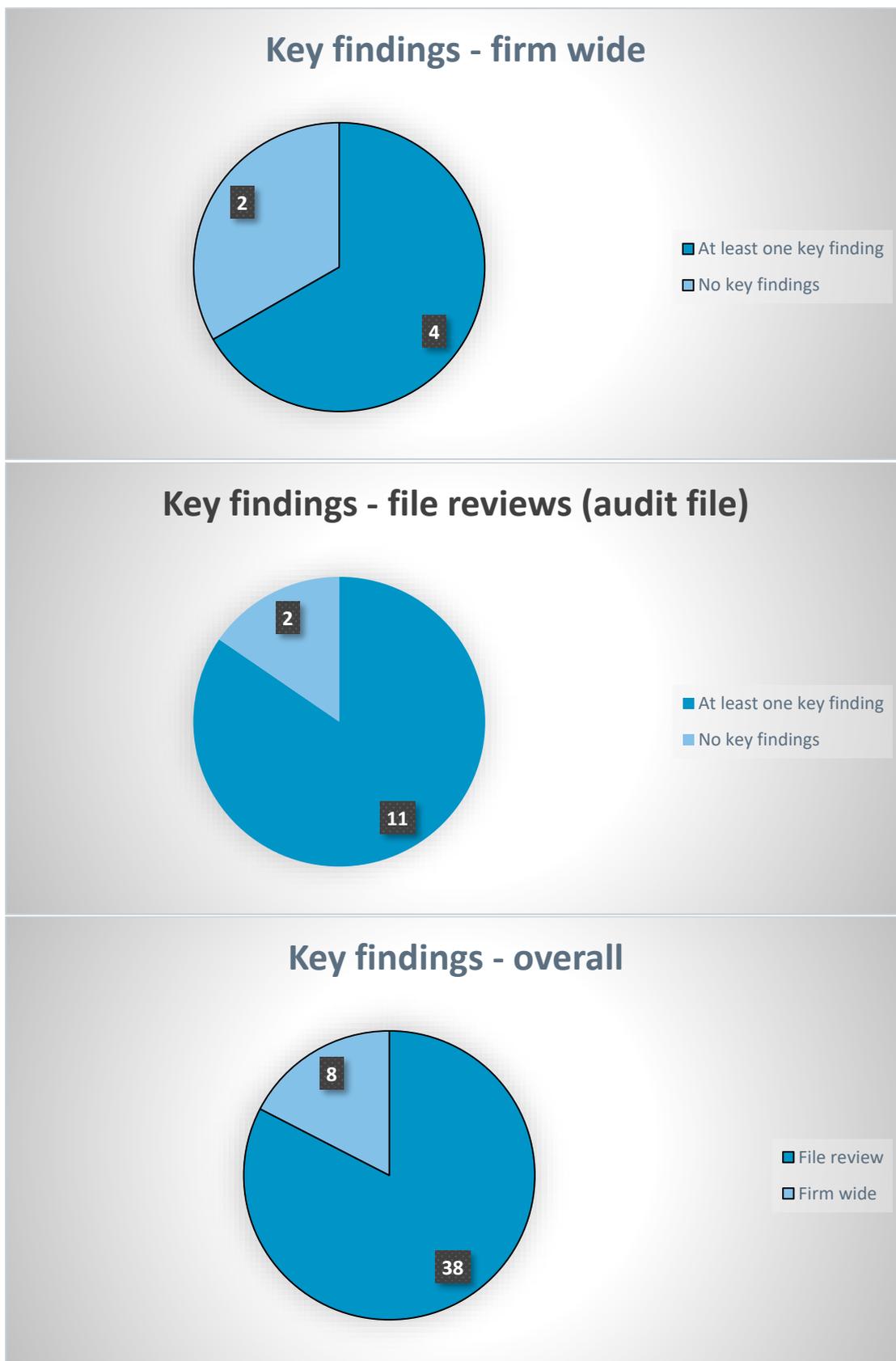
No formal measures were taken as a result of the quality assurance programme.

Sanctions imposed

No sanctions were imposed as a result of the quality assurance programme.

Key performance indicators

Six quality assurance reviews were conducted.



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