GSCCA
Updated Guidance on Audits of Fiduciary Businesses' Accounts
July 2009

The objective of this guidance is to help auditors to ensure a consistent standard in their audits of fiduciary businesses, irrespective of the size or complexity of the business. We hope too that the guidance will help users of audited accounts have a better understanding of the level of audit comfort that may or may not be inferred over the existence and effectiveness of client administration controls.

The guidance aims simply to apply existing auditing standards and guidelines to a particular industry. This is quite separate from any statutory duties that may be placed on auditors by The Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000 ("the Fiduciary Law").

OBJECTIVE OF AUDIT TESTING

The objective of an audit is to enable the auditor to express an opinion as to whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. The phrases used to express the auditors' opinion are "give a true and fair view" or "present fairly, in all material respects", which are equivalent terms.[1]

> An audit in accordance with ISAs (UK and Ireland) is designed to provide reasonable assurance that the financial statements taken as a whole are free from material misstatement. Reasonable assurance is a concept relating to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the financial statements taken as a whole. Reasonable assurance relates to the whole audit process. [2]

In many respects, fiduciary business audits are similar to many others. There are usually sales and purchase ledger systems, often a disbursement ledger, work-in-progress and payroll systems.

However, attention must also be given to the possibility of unrecorded liabilities, particularly those arising from disputes with clients.

KNOWLEDGE OF THE BUSINESS

> The auditor should obtain an understanding of the entity and its environment, including its internal control, sufficient to identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, and sufficient to design and perform further audit procedures. [3]

ISA 315 lists as an appendix matters to consider in relation to knowledge of the business. These include inter alia: internal audit function (existence, quality); attitude to regulatory and internal control environment; products or services and markets; and external factors affecting the entity's business.

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[1] ISA 200 Objective and general principles governing an audit of financial statements
2 ISA 200 Objective and general principles governing an audit of financial statements
[3] ISA 315 Obtaining an Understanding of the Entity and its Environment and Assessing Risks of Material Misstatement.

In relation to unrecorded liabilities; the auditor should understand:

- how the business monitors the size of its exposure to claims from clients;
- whether and to what extent it insures away those risks; and
- how it manages and controls that part (or all) of the risk that it does not insure away.

A suitable understanding of the business, including its control environment and higher level procedures, is also required in order to fulfil any duty the auditor may have to report to the regulator.[4] This requirement is again repeated in connection with money laundering, with emphasis on the practices employed by the business.[5]

ALTERNATIVE AUDIT STRATEGIES

> In order to reduce audit risk to an acceptably low level, the auditor should determine overall responses to assessed risks at the financial statement level, and should design and perform further audit procedures to respond to assessed risks at the assertion level.[6]

There are many different tools available to the auditor to achieve his objectives. He will gain comfort from his assessment of the control environment and business processes, testing of high-level and/or detail controls, key item testing, representative sample testing and analytical review. He will seek to adopt the most efficient combination of these components.

In so doing, he will have regard to the following:

> Audit risk - Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risk of material misstatement (or simply, the "risk of material misstatement") (i.e., the risk that the financial statements are materially misstated prior to audit) and the risk that the auditor will not detect such misstatement ("detection risk"). The risk of material misstatement has two components: inherent risk and control risk (as described at the assertion level below). Detection risk is the risk that the auditor's procedures will not detect a misstatement that exists in an assertion that could be material, individually or when aggregated with other misstatements.[7]

> Control risk - Control risk is the risk that a misstatement that could occur in an assertion and that could be material, individually or when aggregated

[4] ISA 250 Consideration of laws and regulations in an audit of financial statements – Section B – The auditor's right and duty to report to regulators in the financial sector.
[5] PN 12 (Revised) Money Laundering.
[6] ISA 330 – The Auditors' Procedures in response to Assessed Risks.
[7] International Standards on Auditing – Glossary of terms

with other misstatements, will not be prevented or detected and corrected on a timely basis by the entity's internal control.[8]

Inherent risk - Inherent risk is the susceptibility of an assertion to a misstatement, that could be material, individually or when aggregated with other misstatements assuming that there were no related internal controls.[9]

The auditor can only consider the above in relation to unrecorded liabilities if he understands what the fiduciary is doing for his clients and how the fiduciary controls administration of his clients' affairs.

The auditor gains an understanding of the control environment and makes a preliminary assessment of control risk by reviewing client administration controls (this list of example areas is illustrative only and is not intended to be exhaustive):

- client acceptance procedures
- client moneys
- internal audit
- monitoring of complaints and disputes
- adequacy of professional indemnity insurance cover
- client accounting
- ownership of assets
- client closure procedures.

The controls on which the auditor intends to place reliance are then tested using a sample of clients (see below for confidentiality issues) to confirm his preliminary assessment of control risk. The extent of testing of those controls will be determined by the auditor and will vary according to circumstances.

The most efficient audit approach is usually to identify, test and rely on effective controls. A reduced level of substantive testing may then be possible. The absence or failure of such controls would normally give rise to a higher volume of substantive testing and a management letter recommendation. However, the absence of a management letter or of comment in any specific area does not imply any audit comfort over the business's system of internal control.

Irrespective of the assessed risk of material misstatement, the auditor should design and perform substantive procedures for each material class of transactions, account balance, and disclosure. This requirement reflects the fact that the auditor's assessment of risk is judgmental and may not be sufficiently precise to

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[8] International Standards on Auditing – Glossary of terms
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identify all risks of material misstatement. Further, there are inherent limitations to internal control including management override. Accordingly, while the auditor may determine that the risk of material misstatement may be reduced to an acceptably low level by performing only tests of controls for a particular assertion related to a class of transactions, account balance or disclosure, the auditor always performs substantive procedures for each material class of transactions, account balance, and disclosure.[10]

Example audit procedures are not listed in this guidance. The most efficient combination of procedures will vary enormously in line with the size, complexity and effectiveness of the control environment of each business.

CONFIDENTIALITY

The auditor is obliged to treat all client information with the utmost confidentiality. This applies equally to clients' client information. Yet the auditor sometimes encounters resistance to access to client records. It should be possible to perform sufficient audit work without recording client names or addresses on audit files. If necessary, agreement should be sought over the personnel engaged on the audit and who has access to the audit files.

Every effort should be made to resolve this issue. Otherwise, it is doubtful whether the auditor can conclude his audit without qualifying his opinion on scope limitation. If the limitation would result in a disclaimer of audit opinion, the auditor should consider resigning from the engagement.[11]

REPORTING TO THE GUERNSEY FINANCIAL SERVICES COMMISSION

Ensuring compliance with the requirements with which a regulated entity is required to comply in carrying out its business is the responsibility of those charged with governance of the regulated entity. It requires adequate organisation and systems of controls. The regulatory framework provides that adequate procedures for compliance must be established and maintained. Those charged with governance of a regulated entity are also required to undertake regular reviews of compliance and to inform the regulator of any breach of the rules and regulations applicable to its regulated business. In addition, regulators may undertake compliance visits.

The auditor of a regulated entity has responsibility for reporting, subject to compliance with legislation relating to 'tipping off', on particular aspects of the regulated entity's compliance with the regulator's requirements. However, the auditor has no direct responsibility for expressing an opinion on an entity's overall compliance with the requirements for the conduct of its business, nor does an audit provide any assurance that breaches of requirements which are not the subject of regular auditor's reports will be detected.[12]

As noted above, where the auditor identifies the absence or failure of controls, a management letter recommendation is normally made. Rule 10(5) of The Regulation of

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[10] ISA 330 – The Auditors' Procedures in response to Assessed Risks.
[11] ISA 700 The Auditors' Report on the financial statements.
[12] ISA 250 Section B - The Auditor's Right and Duty to Report to Regulators in the Financial Sector

Fiduciaries (Accounts) Rules, 2001 requires the regulated entity to provide the Commission with any management letter, and the Commission also expects the entity to inform it if there is no management letter.