TURKS & CAICOS ISLANDS
FINANCIAL SERVICES COMMISSION

The Audit of Professional Trustees

Guidelines Pursuant to Section 43 of the Financial Services Commission Ordinance

1. INTRODUCTION

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. It is hoped that this 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.

This guidance aims to apply existing auditing standards and guidelines to a particular industry, which is separate from any statutory duties that may be placed on auditors by The Turks and Caicos Islands Trustee Licensing Ordinance (revised August 2009).

2. OBJECTIVE OF AUDIT TESTING

The objective of an audit of financial statements is to enable the auditor to express an opinion on 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]

Pursuant to the International Standards on Auditing (ISA), an audit is designed to provide reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether due to fraud or error. The Audit therefore enhances the degree of confidence of intended users in the financial statements. Reasonable assurance is a concept

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[1] ISA 200 - Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing

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.[2] Reasonable assurance relates to the whole audit process.

In many respects, the audit of fiduciary businesses is similar to the audit of other businesses. This usually involves the review of sales and purchase ledger systems, often a disbursement ledger, work-in-progress and payroll systems.

However, given the nature of fiduciary businesses, consideration must also be given to the possible existence of unrecorded liabilities[3], in particular those arising from disputes with clients.

3. KNOWLEDGE OF THE BUSINESS

The auditor should obtain an understanding of the entity and its environment, including the entity's internal control, in order to sufficiently:

- identify and assess the risks of material misstatement of the financial statements whether due to fraud or error; and
- design and perform further audit procedures.[4]

The appendices of ISA 315 list areas that the auditor should 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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[2] ISA 200 - Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing

[3] In some circumstances the auditor may determine that there is no material risk of unrecorded liabilities, and as such, it may be appropriate that no further procedures be performed on same.

[4] ISA 315 - Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment

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.

In order to fulfil any duty the auditor may have to report to the regulator, the auditor is required to have a suitable understanding of the business, including its control environment and higher level procedures.[5] Further, in accordance with ISA 315, as part of understanding the entity and its business the auditor should have a general understanding of the legal and regulatory framework applicable to the entity (including Anti-Money Laundering and Terrorist financing); the industry or sector in which the entity operates; and how the fiduciary/trustee is complying with that framework. It should be noted that any non-compliance by the fiduciary may have a material effect on the financial statements.

The fiduciary should ensure that its records are kept in such a manner that would enable the auditor to assess the effectiveness of the systems and controls that are maintained to prevent and detect money laundering and the financing of terrorism.[6]

4. ALTERNATIVE AUDIT STRATEGIES

In order to reduce audit risk to an acceptably low level, the auditor should:

- determine overall responses to address the identified and assessed risks of material misstatement at the financial statement level; and

[5] ISA 250 - Consideration of Laws and Regulation in an Audit of Financial Statements
[6] The Proceeds of Crime Ordinance 2007: The Anti-Money Laundering and Prevention of Terrorist Financing Code 2011, Section 35 (1)(c)

- design and perform further audit procedures to address the assessed risks of material misstatements at the assertion level.[7]

There are many different tools available to the auditor to achieve his objectives. He will gain comfort from:

- 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.

The auditor will seek to adopt the most efficient combination of the aforementioned components. In doing so the auditor will have regard for Audit Risks, Control Risks, and Inherent Risks. These risks are defined by ISA[8] as follows:

(i) **Audit Risk** - The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.

a) **Detection Risk** - The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

[7] ISA 330 – The Auditor's Responses to Assessed Risks.
[8] International Standards on Auditing – Glossary of terms

b) **Risk of Material Misstatement** - The risk that the financial statements are materially misstated prior to audit. This consists of two components, namely Control Risk and Inherent Risks, which are described at the assertion level:

(ii) **Control Risk** - The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

(iii) **Inherent Risk** - The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

The auditor can only consider the above in relation to unrecorded liabilities if he understands what the fiduciary is doing for its clients and how the fiduciary controls administration of its 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 auditor should test the controls on which they intend to place reliance by using a sample of clients[9] to confirm his preliminary assessment of control risk. The auditor will also determine the extent of testing of those controls, which may vary according to circumstances.

An efficient audit approach is to identify, test and rely on effective controls, after which a reduced level of substantive testing may be possible. The absence or failure of such controls would normally lead to a higher volume of substantive testing and a management letter recommendation by the auditor. It should be noted however, that the absence of a management letter or of comment in any specific area does not necessarily imply any audit comfort over the business' 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 that the auditor's assessment of risk is judgmental and may not be sufficiently precise to identify all risks of material misstatement. There are also inherent limitations to internal control inclusive of 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 should always perform substantive procedures for each material class of transactions, account balance, and disclosure.[10]

[9] Refer to Point 5 for Confidentiality issues
[10] ISA 330 – The Auditor’s Responses to Assessed Risks

Examples of audit procedures are not listed in this guidance. However, the most efficient combination of procedures used by the auditor will vary significantly based on the size, complexity and effectiveness of the control environment of each business.

5. CONFIDENTIALITY

The auditor is obliged to treat all client information with the utmost confidentiality. This applies equally to their clients' client information.

The auditor may encounter resistance to accessing client records. However, it should be possible to perform sufficient audit work without recording client names or addresses on audit files. If necessary, an agreement should be sought over the personnel engaged on the audit and those persons having access to the audit files.

Every effort should be made to resolve any issues pertaining to the auditor's access of client information. Otherwise, it is doubtful whether the auditor can conclude the audit without qualifying his opinion on scope limitation.[11] If the limitation would result in a disclaimer of audit opinion, then the auditor should consider resigning from the engagement.

6. REPORTING TO THE TURKS AND CAICOS ISLANDS FINANCIAL SERVICES COMMISSION

Those charged with the governance of a regulated entity are responsible for ensuring that the entity is in compliance with the applicable regulatory and statutory requirements. This requires that the entity has adequate organisation and systems of controls in place. The regulatory framework provides that adequate procedures for compliance must be established and maintained. Further, 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

[11] ISA 700 – Forming an Opinion and Reporting on Financial Statements

and regulations applicable to its regulated business. In addition, regulators may undertake compliance visits.

Pursuant to Section 24 of the Trustee Licencing Ordinance Chapter 16.11 (subsections 5 and 7), the auditor (unless otherwise directed by the Commission) is responsible for preparing the fiduciary's Annual Certificate of Compliance. Moreover, 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]

[12] ISA 250 - Consideration of Laws and Regulation in an Audit of Financial Statements