

Alert

Updates on financial reporting, auditing and ethics



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Dear members and member practices,

Compliance work for regulated entities

Practices might be engaged by regulated entities to issue a report on their compliance with relevant regulations, as well as an auditor's report on their financial statements. Regulated entities include licensed corporations regulated by the Securities and Futures Commission (including securities brokers and asset management companies), licensed insurance broker companies regulated by the Insurance Authority, and solicitors regulated by the Law Society of Hong Kong.

Before accepting an engagement to issue a compliance report – or an accountant's report in case of a solicitor – referred to below as a “compliance or regulatory report”; practices should be mindful of the following matters that require specific attention in completing such engagements.

1. Engagement acceptance

Practices should understand that compliance or regulatory reporting is a separate engagement from financial statement reporting and ensure that appropriate terms of engagement are agreed before the commencement of the engagement. Some procedures performed to support the compliance or regulatory reporting (referred to below as “compliance work”) might be covered in carrying out audit work on financial statements. However, specific procedures are usually required to be carried out with reference to the relevant regulations to support the opinions, conclusions or statements given in compliance or regulatory reports.

Practices should review carefully and be satisfied that they have the competencies and resources to properly carry out the compliance work required before taking on compliance or regulatory reporting services.

2. Compliance work

Compliance work requires practices to form opinions or conclusions, or report whether the regulated clients complied with relevant regulations. The Institute has issued a number of practice notes (PNs) to help practices carry out compliance work. These include:

PN 810.1 (Revised)	<i>Licensed Insurance Broker Companies – Compliance with the Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules</i>
PN 820 (Revised)	<i>The Audit of Licensed Corporations and Associated Entities of Intermediaries</i>
PN 840 (Revised)	<i>Reporting on Solicitors' Accounts under the Solicitors' Accounts Rules and the Accountant's Report Rules</i>

Practices should be aware of the practice note applicable to the relevant engagement. Some PNs, such as PN810.1 (Revised) and PN840 (Revised), contain not only guidance but also programmes, which set out relevant procedures, to help practices carry out compliance work.

Although using the programmes in the PNs is not mandatory, practices would be expected to explain why the programmes were not used or followed and what alternative procedures had been carried out in order to support the opinions, conclusions or statements given in compliance or regulatory reports. On the other hand, completion of the programmes should not be taken solely as a form filling exercise that by itself demonstrates compliance with professional standards. Relevant details of the work performed should be recorded in the work papers to provide evidence that the work has been done. Practices must have an adequate understanding of the relevant requirements in order to enable them to carry out appropriate procedures.

In addition, given the specification of the opinions, conclusions or reports required, compliance work should be carried out to support each of the opinions, conclusions or reports given in the compliance or regulatory reports. Adequate documentation is expected to be available on file to support the compliance work. If a practice fails to provide a file or other evidence of basic compliance work to support the compliance or regulatory reports, it would raise serious doubts about not only the competence but also the integrity of the practice.

Examples of a lack of basic compliance work on a licensed corporation client include failing to demonstrate that the client's financial returns had been obtained and tests of controls had been conducted despite there being specific conclusions in the compliance report that the client's financial returns had been properly compiled based on the client's records up to the reporting date and the client had adequate systems in place.

An additional point to note is that there is no materiality concept in compliance reporting of a licensed corporation under the Securities and Futures (Accounts and Audit) Rules. Accordingly, any non-compliance with the relevant regulation found while undertaking the compliance work – regardless of how trivial it is – is

required to be reflected in the compliance report.

3. Compliance reports

As with assurance reports, compliance or regulatory reports should only be dated and issued after all relevant work has been completed. Helping clients to meet the deadlines imposed by the regulators is not an acceptable excuse for dating the compliance or regulatory reports at a date before the work has been completed. In a recent disciplinary case the practitioner, among other charges, dated and issued an auditor's report before all necessary work had been completed. The case resulted in the removal of the practitioner's practising certificate for 24 months. A similar outcome would be expected if a complaint is raised due to backdating of a compliance or regulatory report.

Having a regulated client is considered a higher risk factor in the Institute's practice review selection process. Accordingly, practices with regulated clients will be prioritized for a practice review visit. Since PNs provide suggested procedures on how to carry out relevant work, failure to properly carry out those suggested procedures without reasonable explanation would generally be considered serious and may result in disciplinary actions. Compliance and regulatory reports are received and reviewed by the relevant regulators to safeguard the public interest. Therefore, complaints might also be raised to the Institute if the regulators identified, or were reported, deficiencies in the compliance or regulatory reports, or the underlying work to support the reports issued. Practices should be conscious of the above when accepting and carrying out work on a compliance or regulatory engagement.

It is hoped that the above provides some useful reminders to practitioners before they take on a compliance or regulatory engagement. The Institute's Quality Assurance Department will continue to issue alerts to members on matters arising from the practice review programme.

If you have any questions, please contact the QA hotline 2287-7850 or email qualityassurance@hki CPA.org.hk.

Sincere regards,

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