



20 December 2012

**To: Members of the Hong Kong Institute of CPAs
All other interested parties**

INVITATION TO COMMENT ON EXPOSURE DRAFT PRACTICE NOTE

**ED Revised Practice Note 620.2 *Communication between the Auditor
and the Insurance Authority***

Comments to be received by 20 January 2013

The Hong Kong Institute of Certified Public Accountants' (Institute) Auditing and Assurance Standards Committee is seeking comments on the ED which has been posted on the Institute's website at:

<http://www.hkicpa.org.hk/en/standards-and-regulations/standards/auditing-assurance/exposure-drafts/>

The AASC has embarked on a project, with the assistance of the Institute's Insurance Regulatory Liaison Group, to align the extant Practice Notes (PN) with the development of the auditing and assurance pronouncements issued. As part of the project, the proposed revised PN 620.2 has been updated to align with the clarified Hong Kong Standards on Auditing (HKSA) and the current drafting conventions.

In order for readers to easily identify all the changes, we have attached a marked up version and a clean version of the ED.

Comments on the proposed changes should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the Exposure Draft to be considered, comments are requested by the due date shown above.

Comments may be sent by mail, fax or e-mail to:

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Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

20 December 2012
Exposure Draft

Response Due Date
20 January 2013

ED of Revised PN 620.2

Communication between the Auditor and the Insurance Authority



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ED of Revised PN 620.2 "Communication between the Auditor and the Insurance Authority"

This Exposure Draft may be filed in the "Exposure Drafts, Invitations to Comment" section of Volume III of the Institute Members' Handbook.

The Exposure Draft can also be found on the Institute's website at:

<http://www.hkicpa.org.hk/en/standards-and-regulations/standards/auditing-assurance/exposure-drafts/>.



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Practice Note 620.2

Communication between the Auditor and the Insurance Authority



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PRACTICE NOTE

620.2

**COMMUNICATION BETWEEN THE AUDITOR AND
THE INSURANCE AUTHORITY**

(Issued May 1998; revised September 2004 (name change); revised [])

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Practice Note (PN) 620.2 "Communication between the Auditor and the Insurance Authority" should be read in the context of the "Amended Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements" which sets out the application and authority of PNs.

PRACTICE NOTE

620.2

COMMUNICATION BETWEEN THE AUDITOR AND THE INSURANCE AUTHORITY

The purpose of Practice Notes issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) is to assist the auditor in applying Hong Kong Engagement Standards of general application to particular circumstances and industries.

Practice Notes are persuasive rather than prescriptive. However they are indicative of good practice and have similar status to the explanatory material in Hong Kong Engagement Standards. This Practice Note provides guidance to assist the auditor to fulfill the objectives of the engagement. The auditor should be prepared to explain departures when called upon to do so.

Introduction

1. In this Practice Note all the sections mentioned below are in respect of the Hong Kong Insurance Companies Ordinance ("the Ordinance") unless otherwise stated.
2. Section 53D of the Ordinance provides statutory protection for the auditor from liability to the client for breach of confidentiality when the auditor communicates directly with the Insurance Authority. Sections 15A and 53E impose a statutory obligation on the auditor to report certain matters directly to the Insurance Authority.
3. This Practice Note refers to the auditor, audits, reports on the annual financial statements and reports on the accounts and statements ("financial information") an insurer is required to submit to the Insurance Authority.
4. This Practice Note is applicable to:
 - a. an auditor or former auditor of an insurer or a former insurer appointed under section 15 or section 4(1A) of Part 1 of the Third Schedule to the Ordinance ("the Third Schedule");
 - b. an accountant or former accountant of an insurer or a former insurer appointed in compliance with a requirement under section 35(1); and
 - c. an auditor or former auditor of an insurance broker or a former insurance broker appointed under section 72.

Scope of the Ordinance

5. The Ordinance regulates the carrying on of insurance business in Hong Kong. One of the primary purposes of the Ordinance is the protection of policy holders and potential policy holders. The Insurance Authority is charged under section 4A with the functions set out below.
 - a. The principal function of the Insurance Authority shall be to regulate and supervise the insurance industry for the promotion of the general stability of the insurance industry and for the protection of existing and potential policy holders (section 4A(1)).
 - b. Without limiting the generality of section 4A(1), the Insurance Authority shall:
 - i. be responsible for supervising an insurer's and an insurance intermediary's compliance with the provisions of the Ordinance;
 - ii. consider and propose reforms of the law relating to insurance business;

- iii. promote and encourage proper standards of conduct and sound and prudent business practices amongst insurers;
 - iv. promote and encourage proper standards of conduct of insurance intermediaries and, where necessary, review and revise the regulatory system for the same;
 - v. promote and develop self-regulation by market and professional bodies of the insurance industry; and
 - vi. co-operate with and assist financial services supervisory authorities of Hong Kong or of any place outside Hong Kong, whenever appropriate, to the extent permitted by the Ordinance (section 4A(2)).
- c. The Insurance Authority may from time to time cause to be prepared and published by notice in the Gazette, for the guidance of authorized insurers, insurance intermediaries, and the auditors and actuaries of such insurers and intermediaries, guidelines not inconsistent with the Ordinance, indicating the manner in which the Insurance Authority proposes to exercise functions imposed or conferred upon by the Ordinance (section 4A(3)).
6. The Third Schedule specifies the form and content of the financial information which an insurer is required to submit annually to the Insurance Authority. The auditor is required to report on the financial information and the report will in general terms cover such matters as:
- a. the maintenance of proper books and records by the insurer;
 - b. the proper preparation of the financial information;
 - c. the fairness of presentation of the financial information;
 - d. the valuation of assets and liabilities in accordance with applicable valuation regulations; and
 - e. the maintenance of assets in accordance with the Ordinance.

Detailed guidance is set out in PN 810.2 "The Duties of Auditors under the Insurance Companies Ordinance".

7. Section 73(1) specifies the form of financial statements which an authorized insurance broker, authorized by the Insurance Authority under section 69(2), is required to submit annually to the Insurance Authority. The auditor is required to report on the authorized insurance broker's financial statements and compliance with the minimum requirements regarding
- a. capital and net assets;
 - b. professional indemnity insurance;
 - c. keeping of separate client accounts; and
 - d. keeping proper books and accounts.

Under section 73(2) the auditor of an approved body of insurance brokers, approved by the Insurance Authority under section 70(2), is required to report:

- a. whether the body of insurance brokers has received from each of its members the audited financial statements and report by the auditor on the compliance with the minimum requirements specified by the Insurance Authority in accordance with its membership rules and regulations; and

- b. that the auditor has reviewed all reports by auditors of members in respect of the financial statements and the minimum requirements and none contained any adverse statement or qualification except those listed by the auditor in the auditor's report.

Detailed guidance is set out in PN 810.1 "Insurance Brokers – Compliance with the Minimum Requirements Specified by the Insurance Authority Under Sections 69(2) and 70(2) of the Insurance Companies Ordinance".

- 8. In addition, insurers, authorized insurance brokers and approved bodies of insurance brokers who are incorporated in Hong Kong are required to prepare financial statements and to have them audited under the provisions of the Hong Kong Companies Ordinance.
- 9. In the course of performing the work necessary to discharge these routine audit reporting responsibilities, the auditor may become aware of matters which the auditor considers need to be brought to the Insurance Authority's attention through an "ad hoc report", other than through the medium of the routine formal audit report.
- 10. This Practice Note is concerned only with ad hoc communications between the auditor and the Insurance Authority:
 - a. by the auditor to the Insurance Authority under the obligations established in sections 15A(2) and 53E;
 - b. by the auditor to the Insurance Authority under the protection of section 53D; and
 - c. by the Insurance Authority to the auditor under section 53A(3)(da) and (3)(f).

It does not cover the auditor's approach to the audit of an insurer, an authorized insurance broker or an approved body of insurance brokers or the routine audit reporting responsibilities.

- 11. Certain expressions used in the Ordinance may be matters for legal interpretation. There may, therefore, be circumstances in which, notwithstanding the guidance in this Practice Note, the auditor will wish to take legal advice.

Reporting under the Ordinance

- 12. The Insurance Authority expects that the management of an insurer or an insurance broker will continue to be its primary source of information and that the normal authorized reporting procedures, including returns, discussions, examinations and any tripartite meetings will normally provide the Insurance Authority with most of the information it needs to carry out its responsibilities under the Ordinance.
- 13. Nevertheless under the Ordinance the auditor has various statutory responsibilities to report to the Insurance Authority. The auditor is automatically protected in making a report in discharge of such a statutory responsibility. Certain provisions also provide the auditor with immunity from any liability the auditor might otherwise incur by reason of the auditor's making other reports to the Insurance Authority which the auditor may consider to be relevant to the functions of the Insurance Authority. These responsibilities and avenues available for reporting do not require the auditor to change the scope of the audit work, nor the frequency or timing of the visits.

14. When the circumstances where reporting may be appropriate are being considered, it should be noted that obtaining insurance services or products carries inherent risks. It is not the purpose of the Ordinance, nor the duty of the auditor, to protect the policy holder from the normal risks relating to such activities.
15. The auditor is advised to bear in mind that the auditor's decision may have to stand up to examination at a future date on the basis of the following considerations:
 - a. what the auditor knew at the time;
 - b. what the auditor should have known in the course of the audit;
 - c. what the auditor should have concluded; and
 - d. what the auditor should have done.

The auditor's notices to the Insurance Authority under section 15A(2)

16. The auditor has a statutory duty to give immediate written notice to the Insurance Authority in the circumstances set out below.
 - a. If the auditor resigns (section 15A(2)(a)).
 - b. If the auditor decides not to seek reappointment (section 15A(2)(b)).
 - c. If the auditor decides to add a qualification or adverse statement to the auditor's report annexed to the financial information of the insurer required to be submitted under the Third Schedule (section 15A(2)(c)).

The decision to give written notice would normally only be taken after extensive discussions with management and when a problem is either irremediable or when the circumstances indicate that the auditor intends to qualify.

Section 15A(2) applies to the auditor of an insurer appointed under section 15 or section 4(1A) of Part 1 of the Third Schedule.

Ad hoc reports under section 53E

17. Section 53E provides that where an auditor, during the performance of the duties in that capacity:
 - a. becomes aware of any matter... which in the auditor's opinion adversely affects the financial condition of the insurer to a material extent, the auditor shall, as soon as practicable thereafter, send to the Insurance Authority a report in writing of the matter (section 53E(1)); and
 - b. becomes aware of evidence...
 - i. of a failure by the insurer to comply with any conditions imposed under section 8(1)(a);
 - ii. that there exists a ground on which the Insurance Authority would be prohibited by section 8(3)(a), (b), (d) or (f) from authorizing the insurer if the insurer were to make application in that behalf;
 - iii. of a failure by the insurer to comply with any of the provisions of section 22, 22A or 23; or

- iv. of any default of the insurer in complying with any requirement under section 27, 28, 29, 30, 31, 32, 33, 34 or 35(1),

the auditor shall, as soon as practicable thereafter, send to the Insurance Authority a report in writing of the failure, ground or default (section 53E(3)).

Section 53E applies to:

- a. an auditor or former auditor of an insurer or a former insurer appointed under section 15 or section 4(1A) of Part 1 of the Third Schedule; and
- b. an accountant or former accountant of an insurer or a former insurer appointed in compliance with a requirement under section 35(1).

These are statutory obligations and the following paragraphs of the Practice Note provide the auditor with procedures to follow when such circumstances arise.

Reporting criterion under section 53E

- 18. The auditor would take the initiative and ensure that an ad hoc report under section 53E is made to the Insurance Authority if the conditions specified in paragraph 17 exist. A distinction must be drawn here between an auditor's duty as stated in paragraph 17(a) and that stated in paragraph 17(b). The duty under paragraph 17(b) is clear and unequivocal; if the auditor becomes aware of a contravention of the provisions in the Ordinance which are specified, the auditor is not given any latitude for exercising judgement. The auditor is obliged to make a report. The duty under paragraph 17(a) is different. The auditor is given the right to form an opinion based on applying criteria as to the materiality of an adverse effect on the insurer's financial position in deciding whether reporting would be appropriate.

The HKICPA has developed a criterion for use by the auditor in deciding to take the initiative in making an ad hoc report under section 53E in addition to the regular audit reporting responsibilities. The criterion is that the auditor would make the report when the auditor considers it expedient to do so in order for the Insurance Authority to protect the interests of policy holders because there has been a material loss or there exists a significant risk of material loss.

- 19. This criterion can be more fully explained as follows:
 - a. there must be a significant adverse occurrence or a change in the auditor's perception of an existing situation, that may include an adverse change in the circumstances of the business; and
 - b. the situation described in a. above has given rise to or has indicated that a reasonable probability exists that it may give rise to:
 - i. a material financial loss to the business, or
 - ii. loss of control over the assets or records.
- 20. Examples of the circumstances in which the situation set out in paragraphs 18 and 19 may be met include:
 - a. the auditor discovers a failure by the insurer to comply with the relevant provisions of the Ordinance which may have material consequences; or
 - b. there is evidence of imminent financial loss of serious proportions which might cast doubt on the continuing viability of the insurer.

Reporting procedures under section 53E

21. In circumstances where the auditor concludes that an ad hoc report under section 53E to the Insurance Authority is necessary, the auditor would normally adopt the procedures set out below, bearing in mind that speed may be of the essence and that the statutory obligation to report under section 15A or 53E remains subject to the criterion discussed in paragraphs 18 - 20.
- a. The auditor would normally discuss the matter with the insurer and explain the statutory duty to make a report to the Insurance Authority under section 53E. In addition, the insurer may be advised to make its own report to the Insurance Authority immediately.
 - b. The auditor would normally then immediately inform the Insurance Authority of the circumstances in writing. It is suggested that a copy of both the written notification and the ad hoc report be made to the directors or management of the insurer.
22. The auditor is reminded that making an ad hoc report alone may not discharge all the responsibilities. For example, the auditor would consider the implications of the matter giving rise to the ad hoc report for the auditor's opinion on the financial statements.

Other ad hoc communications by the auditor

Statutory protection under section 53D

23. Section 53D provides that:
- "(1) No duty which a prescribed person may be subject to shall be regarded as contravened by reason of his communicating in good faith to the Insurance Authority, whether or not in response to a request made by the Insurance Authority, any information or opinion on a matter:
- a. of which he becomes aware in his capacity as a prescribed person...; and
 - b. which is relevant to any function of the Insurance Authority under this Ordinance.
- (2) For the avoidance of doubt, it is hereby declared that a matter referred to in subsection (1) may be a matter which relates to a person other than an insurer or former insurer."
24. For the purposes of section 53D, "prescribed person" in this context refers to:
- a. an auditor or former auditor of an insurer or a former insurer appointed under section 15 or section 4(1A) of Part 1 of the Third Schedule;
 - b. an accountant or former accountant of an insurer or a former insurer appointed in compliance with a requirement under section 35(1); and
 - c. an auditor or former auditor of an insurance broker or a former insurance broker appointed under section 72.
25. Section 53D does not lay down any rules nor specify the circumstances in which the auditor is to communicate any matter to the Insurance Authority. It provides a statutory mechanism whereby the auditor may make matters known to the Insurance Authority without breaching the auditor's duty of confidentiality.

26. This section of the Practice Note contains guidance on the circumstances in which matters (which fall outside those which the auditor is obliged to report (see paragraphs 16 to 22 above)) may be brought to the attention of the Insurance Authority by way of a report with statutory protection. In interpreting this guidance, the auditor is advised to bear in mind the fundamental objectives of the legislation, which are to ensure that the Insurance Authority is able to fulfil its functions summarised in paragraph 5.
27. Confidentiality is an implied term of an auditor's contract with the client, but in certain circumstances and under conditions specified in section 53D it does not prevail, since the auditor is entitled to communicate information or opinions on a matter relating to the business or affairs of the client relevant to the Insurance Authority's functions without the duty of confidentiality owed to the client being regarded as having been contravened.
28. The matters which may be communicated under section 53D are any of those relevant to the Insurance Authority's functions under the Ordinance.
29. Matters which may be reported under the protection of section 53D will only arise in circumstances where the auditor is under no duty to report under section 15A or 53E. Considerable care needs to be taken in disclosing matters arising during any tripartite meeting with the Insurance Authority as the auditor's knowledge of these matters may have been obtained while assisting the Insurance Authority other than in the capacity as the auditor (see paragraph 32).

Examples of circumstances in which the auditor may communicate a matter to the Insurance Authority under section 53D include:

- a. the auditor considers policy holders have incurred, or are at significant risk of incurring, a material loss as a result of insurers or authorized insurance brokers carrying on business in a manner that is not fit and proper or that is in breach of the Ordinance;
 - b. there is evidence of
 - i. fraud, dishonesty or serious incompetence; or
 - ii. serious failure to observe requirements of the Ordinance or conditions imposed on the insurer or authorized insurance broker by the Insurance Authority;
 - c. it has come to the attention of the auditor that the procedures, records or systems fail significantly to comply with, or to demonstrate compliance with, requirements set by the Insurance Authority to which the insurer or authorized insurance broker is subject; and
 - d. the position is such that because of a significant risk which is material to the collective interests of policy holders, the policy holders' interests would be better safeguarded if the Insurance Authority were aware of the position, even if only to organise protective action.
30. Clearly the potential nature of matters which may be reported is very wide, but as explained in paragraph 33 this does not, of itself, require the auditor to extend the scope of the work in order to discover matters and it will only be in exceptional circumstances such as those described in paragraph 48 that the auditor may choose to seek statutory protection.

31. Any protected communication can be made either on the auditor's initiative or in response to a request from the Insurance Authority for information. The auditor would normally cooperate with the Insurance Authority and respond to any requests from the Insurance Authority for information, provided the auditor has no reason to doubt that the request is relevant to the Insurance Authority's functions. The auditor may communicate a matter to the Insurance Authority with the protection of section 53D regardless of the source of that information, provided the auditor became aware of the matter in the capacity as the auditor of the client and the auditor does so in good faith.
32. Matters of which the auditor becomes aware "in the capacity as the auditor" may not be restricted to those matters identified by the auditor during the course of the audit work. The auditor may become aware of a matter which is relevant to the functions of the Insurance Authority during the course of the work for the insurer or authorized insurance broker other than audit work or through private discussions on social or other occasions, in which case the information will be known to the auditor as individual. In circumstances which suggest that a matter would be reported to the Insurance Authority if knowledge of it had been obtained in the capacity as the auditor, it would be prudent to make enquiries in the course of the audit work in order to establish whether this is the case from information obtained in this capacity. In addition, a matter which is relevant to the functions of the Insurance Authority and which is identified during the course of work for the client by another partner (or member of staff) such as a management consultant or tax partner may be deemed to be known to the auditor (see also paragraph 34). The auditor may follow the guidance set out in HKSA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements"
33. The auditor cannot be expected to be aware of all circumstances which, had the auditor known of them, would have led the auditor to exercise the right to communicate under section 53D. This section does not require the auditor to change the scope of the audit or other work for the client, nor the frequency or timing of the visits. The auditor has no obligation to seek out grounds for making a report under section 53D. The section does not place an obligation on the auditor to conduct the work in such a way that there is reasonable certainty that the auditor will discover a matter upon which the Insurance Authority may need to act. It is only when the auditor does become aware in the ordinary course of the work of such a matter, or of circumstances which suggest the existence of such a matter, that the auditor would consider using the protection of section 53D.
34. The auditor would, however, ensure that the auditor is made aware of any other relationships which may exist between any department of the firm and the client which could affect the work as the auditor. The Insurance Authority expects that the auditor will ensure that the auditor is informed of all potentially exceptional circumstances (paragraphs 48 and 49) by all other departments within the firm which have a relationship with the insurer or authorized insurance broker. It would, therefore, be prudent for the audit firm to ensure any exceptional circumstances which may give rise to reports under section 53D are brought to the attention of the auditor of the client in order that the auditor can, if appropriate, make enquiries in the capacity as the auditor to ascertain whether such matters should be reported to the Insurance Authority.
35. The Insurance Authority recognises that it would not be appropriate for the auditor to report information which the auditor has obtained or matters which the auditor has identified through the professional relationship with another client, even though the information obtained or the matters identified may relate to an insurer or an authorized insurance broker. However, the Insurance Authority expects an insurer or authorized insurance broker to advise its auditor when it appoints a third party (including another department of the same firm) to review, investigate or report on any aspects of its records and systems and to provide the auditor with copies of reports by such a third party promptly after their receipt. The auditor can, if appropriate, make enquiries in the capacity as the auditor to ascertain whether any findings of the reports should be reported to the Insurance Authority.

36. It should be noted that section 53D will not provide protection to the auditor where the auditor could be held to have acted maliciously or in bad faith or if the information reported is outside the scope of that section. The Ordinance does not, therefore, provide complete immunity from all types of legal action by all parties affected, or subsequently affected, by the auditor's action in reporting to the Insurance Authority. The auditor would consider taking legal or other professional advice before making the decision about whether, or in what manner, to report and in order, for example, to ensure that the form and content of the report are such as to secure the protection of section 53D and that it only includes relevant material.
37. The auditor is protected, however, even if the information which the auditor communicates falls short of proof, or the opinion which the auditor communicates cannot be verified. The auditor who can demonstrate that the auditor has acted reasonably and in good faith in informing the Insurance Authority of a reportable matter would not be held in breach of duty to the client even if, after an investigation, it were found there was not a matter which needed to be reported. These are areas where the auditor may wish to consider taking legal advice before making a report.
38. Whilst no breach of statutory duty might arise, it should be appreciated that there is no protection given by the Ordinance if the auditor, after becoming aware of an occurrence, fail to report, promptly, or at all, to the Insurance Authority. Furthermore, it should be recognised that speed of reporting is likely to be important in order to enable the Insurance Authority to protect the interests of policy holders.

Meetings with the Insurance Authority

39. As part of the Insurance Authority's system of supervision of insurers or authorized insurance brokers, meetings involving the Insurance Authority, the insurer or authorized insurance broker and its auditor may be called. These meetings may be categorised as "routine meetings" called by the Insurance Authority or "special meetings" which may be called by either the Insurance Authority, or the insurer or authorized insurance broker possibly at the auditor's suggestion.
40. The agenda for a tripartite meeting between the Insurance Authority, the insurer or authorized insurance broker and the auditor will be prepared by the Insurance Authority and will include items requested by the insurer or authorized insurance broker and auditor and be circulated in advance. The auditor is expected to participate fully in tripartite meetings and to have regard to the breadth of the Insurance Authority's functions. Normally, however, it is expected that the auditor will discuss with the client any matter which is to be raised at a meeting with the Insurance Authority, before the meeting is held.
41. The auditor would be expected to discuss with the Insurance Authority the affairs of the insurer or authorized insurance broker including, if necessary, information about its policy holders or other companies within the group obtained in the course of that work. However, the Insurance Authority recognises that it would not be appropriate for the auditor to report to the Insurance Authority information about the insurer or authorized insurance broker which the auditor has obtained through the professional relationship with another client.
42. Meetings may be called by the Insurance Authority to assist in its forming a judgement on an insurer or authorized insurance broker. In particular discussions may cover:
 - a. the presentation and content of the annual financial statements;
 - b. the scope, conduct and outcome of the annual audit;
 - c. the scope and outcome of any report made under section 53E;
 - d. explanations for, the reasons for and the nature of a qualified report or of a change in a previously reported intention to qualify a report;
 - e. any step or course of action which may be necessary in the light of the reports, for example, the commissioning of a more detailed report in a particular area; and

- f. matters raised by the Insurance Authority or those which the insurer or authorized insurance broker or auditor have drawn to its attention since any previous meeting, including how such matters have been resolved to the satisfaction of the auditor or have been reflected or treated in the financial statements.
43. Any party may seek to call a tripartite meeting at any other time if important matters affecting the insurer or authorized insurance broker come to their attention as further discussed in paragraph 45. Normally, the auditor would raise the concerns with the insurer or authorized insurance broker first and if the problem cannot be resolved to the auditor's satisfaction, suggest that the insurer or authorized insurance broker asks the Insurance Authority to convene a meeting.
44. In exceptional circumstances, for example, those outlined in paragraphs 48 and 49, the auditor may consider it necessary to have a bipartite meeting with the Insurance Authority to discuss the affairs of the insurer or authorized insurance broker or to draw the attention of the Insurance Authority to information about the insurer or authorized insurance broker without its knowledge. Before doing so, however, the auditor would consider taking timely legal advice and whether a representative of the insurer or authorized insurance broker at an appropriately senior level would be informed and invited to attend the meeting.

Reporting via the insurer or authorized insurance broker

45. Where the auditor becomes aware of a matter which, in the auditor's professional judgement, the auditor considers is not required to be reported under section 15A or 53E but ought to be reported to the Insurance Authority, the auditor would consider the facts and, unless inappropriate in the circumstances (described in paragraph 48), discuss the matter with the management.
46. It is important for the auditor to act in a manner that will maintain the professional relationship with the client. Normally, therefore, the auditor would ask the insurer or authorized insurance broker to draw matters about which the auditor is concerned to the attention of the Insurance Authority. An example of the circumstances under which the auditor is not required to report but about which the auditor might wish to persuade the client to inform the Insurance Authority are where the auditor forms the opinion that management has reported materially misleading financial information to the Insurance Authority or becomes aware that management has failed, or does not intend, to report something and the failure to report is, or would be, materially misleading.
47. Where the insurer or authorized insurance broker will not himself inform the Insurance Authority of a matter, having been advised to do so by the auditor, or where it has not been done within the period of time specified, or where there is not adequate evidence that the client has properly reported the matter in question, the auditor would make such a report direct to the Insurance Authority.

Reporting direct to the Insurance Authority

48. In exceptional circumstances, where the auditor doubts whether management are fit and proper persons to carry on the business of insurance and it would be in the interest of protecting policy holders that the management of the insurer or authorized insurance broker should not be informed in advance, the auditor would report directly to the Insurance Authority after first considering the appropriateness of taking independent legal advice. Examples of such circumstances include:
- a. where there has been an occurrence which causes the auditor no longer to have confidence in the integrity of the directors or senior management, e.g. where the auditor believes that a fraud or other irregularity has been committed by the directors or senior management of the insurer or authorized insurance broker, or the auditor has evidence of the intention of directors or senior management to commit such a fraud or other irregularity; or

- b. where there has been an occurrence which causes the auditor no longer to have confidence that the directors or senior management will conduct the business of the insurer or authorized insurance broker in a prudent manner so as to protect the interests of policy holders, e.g. where the auditor has discovered that the directors or senior management are acting in an irresponsible or reckless manner with respect to the affairs of the business or its policy holders, or the auditor has evidence of the inclination so to act.
49. The auditor would also report directly to the Insurance Authority when speed is of the essence. For example, when the auditor becomes aware that the insurer or authorized insurance broker may be about to cease being authorized, the auditor would consider the need to disclose to the Insurance Authority any information in the auditor's possession relevant to its functions without delay. The fact of such impending cessation of authorization may bring forward the desirability of disclosing matters to the Insurance Authority, as it is easier for the Insurance Authority to take appropriate action while the insurer or authorized insurance broker is still authorized, particularly where such matters have a bearing on the security of third party interests.

Communications by the Insurance Authority to the auditor under section 53A(3)(da) and (3)(f)

50. The Ordinance also deals with communications by the Insurance Authority to the auditor of an insurer, an authorized insurance broker or an approved body of insurance brokers.
- a. Section 53A(3)(da) permits the communication of restricted information to the auditor of an insurer or authorized insurance broker for the purpose of enabling or assisting the Insurance Authority to discharge its functions under the Ordinance without the consent of the person from whom it is received or to whom it relates.
 - b. Section 53A(3)(f) permits the communication by the Insurance Authority to the auditor if, in the opinion of the Insurance Authority, such information is necessary for the auditor to perform the duties under the Ordinance.
51. It should be noted that disclosure by the Insurance Authority of confidential information to the auditor is to the auditor only; the auditor is not free to pass that information to others, such as the client insurer or authorized insurance broker without the consent of the Insurance Authority under section 53A(3D) of the Ordinance.
52. The Insurance Authority has indicated that it will take the initiative in reporting any matter to the auditor of an insurer or authorized insurance broker under the provisions of section 53A(3)(da) and (3)(f), where it believes that it is of such importance that the auditor's knowledge of it could significantly affect the form of the audit report or the way in which the auditor carries out the reporting responsibilities. The Insurance Authority has also indicated that it will inform the auditor whether the management of the insurer or authorized insurance broker has been informed of the matter and, if so, who has been advised.
53. In the absence of any notification, the auditor is entitled to assume that the Insurance Authority has considered the need to take such an initiative and has concluded that it has no matters to report to the auditor of an insurer or authorized insurance broker. Accordingly there is no need for the auditor to request the Insurance Authority to confirm this.

Practice Note 620.2

Communications bBetween the Auditors and tThe Insurance Authority



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Practice Note (PN) 620.2 "Communication between the Auditor and the Insurance Authority" should be read in the context of the "Amended Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements" which sets out the application and authority of PNs.

PRACTICE NOTE

620.2

COMMUNICATIONS BETWEEN THE AUDITORS AND THE INSURANCE AUTHORITY

The purpose of Practice Notes issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) is to assist the auditors in applying ~~Auditing~~ Hong Kong Engagement Standards of general application to particular circumstances and industries.

~~They~~ Practice Notes are persuasive rather than prescriptive. However they are indicative of good practice and have similar status to the explanatory material in ~~Statements of Auditing~~ Hong Kong Engagement Standards (SASs), even though they may be developed without the full process of ~~consultation and exposure used for SASs~~. This Practice Note provides guidance to assist the auditor to fulfill the objectives of the engagement. The Auditors should be prepared to explain departures when called upon to do so.

Preface

Introduction

1. In this Practice Note all the sections mentioned below are in respect of the Hong Kong Insurance Companies Ordinance ("the Ordinance") unless otherwise stated.
2. Section 53D of the Ordinance ~~introduces~~ provides statutory protection for the auditors from liability to their client for breach of confidentiality when they auditor communicates directly with the Insurance Authority. Sections 15A and 53E impose a statutory obligation on the auditors to report certain matters directly to the Insurance Authority.
3. This Practice Note refers to the auditors, audits, reports on the annual financial statements and reports on the accounts and statements ("financial information") an insurer is required to submit to the Insurance Authority.
4. This Practice Note is applicable to:
 - a. ~~1.~~ an auditors or former auditors of an insurers or a former insurers appointed under section 15 or section 4(1A) of Part 1 of the Third Schedule to the Ordinance ("the Third Schedule");
 - b. ~~2.~~ an accountants or former accountants of an insurers or a former insurers appointed in compliance with a requirement under section 35(1); and
 - c. ~~3.~~ an auditors or former auditors of an insurance brokers or a former insurance brokers appointed under section 72.

IntroductionScope of the Ordinance

45. The Ordinance regulates the carrying on of insurance business in Hong Kong. One of the primary purposes of the Ordinance is the protection of policy holders and potential policy holders. The Insurance Authority is charged under section 4A with the functions set out below.
 - a. The principal function of the Insurance Authority shall be to regulate and supervise the insurance industry for the promotion of the general stability of the insurance industry and for the protection of existing and potential policy holders (section 4A(1)).

- b. Without limiting the generality of section 4A(1), the Insurance Authority shall:
- i. be responsible for supervising an insurer's and an insurance intermediary's compliance with the provisions of the Ordinance;
 - ii. consider and propose reforms of the law relating to insurance business;
 - iii. promote and encourage proper standards of conduct and sound and prudent business practices amongst insurers;
 - iv. promote and encourage proper standards of conduct of insurance intermediaries and, where necessary, review and revise the regulatory system for the same;
 - v. promote and develop self-regulation of ~~the~~by market and professional bodies of the insurance industry; and
 - vi. co-operate with and assist financial services supervisory authorities of Hong Kong or of any place outside Hong Kong, whenever appropriate, to the extent permitted by the Ordinance (section 4A(2)).
- c. The Insurance Authority may from time to time cause to be prepared and published by notice in the Gazette, for the guidance of authorized insurers, insurance intermediaries, and the auditors and actuaries of such insurers and intermediaries, guidelines not inconsistent with the Ordinance, indicating the manner in which ~~he~~the Insurance Authority proposes to exercise functions imposed or conferred upon ~~him~~by the Ordinance (section 4A(3)).

26. The Third Schedule specifies the form and content of the financial information which an insurer is required to submit annually to the Insurance Authority. The auditors ~~are~~is required to report on the financial information and the report will in general terms cover such matters as:

- a. the maintenance of proper books and records by the insurer;
- b. the proper preparation of the financial information;
- c. the fairness of presentation of the financial information;
- d. the valuation of assets and liabilities in accordance with applicable valuation regulations; and
- e. the maintenance of assets in accordance with the Ordinance.

Detailed guidance is set out in PN 810.2 "The Duties of Auditors under the Insurance Companies Ordinance".

37. Section 73(1) specifies the form of financial statements which an authorized insurance broker, authorized by the Insurance Authority under section 69(2), is required to submit annually to the Insurance Authority. The auditors ~~is~~are required to report on the authorized insurance broker's financial statements and compliance with the minimum requirements regarding

- a. capital and net assets;
- b. professional indemnity insurance;
- c. keeping of separate client accounts; and
- d. keeping proper books and accounts.

Under section 73(2) the auditors of an approved body of insurance brokers, approved by the Insurance Authority under section 70(2), ~~are~~is required to report:

- a. whether the body of insurance brokers has received from each of its members the audited financial statements and report by the auditors on the compliance with the minimum requirements specified by the Insurance Authority in accordance with its membership rules and regulations; and
- b. that the auditory ~~has~~ve reviewed all reports by auditors of members in respect of the financial statements and the minimum requirements and none contained any adverse statement or qualification except those listed by ~~them~~ auditor in their auditor's report.

Detailed guidance is set out in PN 810.1 "Insurance Brokers – Compliance with the Minimum Requirements Specified by the Insurance Authority Under Sections 69(2) and 70(2) of the Insurance Companies Ordinance".

48. In addition, insurers, authorized insurance brokers and approved bodies of insurance brokers who are incorporated in Hong Kong are required to prepare financial statements and to have them audited under the provisions of the Hong Kong Companies Ordinance.

59. In the course of performing the work necessary to discharge these routine audit reporting responsibilities, the auditors may become aware of matters which they auditor considers need to be brought to the Insurance Authority's attention through an "ad hoc report", other than through the medium of the routine formal audit report.

610. This Practice Note is concerned only with ad hoc communications between the auditors and the Insurance Authority:

- a. by the auditors to the Insurance Authority under the obligations established in sections 15A(2) and 53E;
- b. by the auditors to the Insurance Authority under the protection of section 53D; and
- c. by the Insurance Authority to the auditors under section 53A(3)(da) and (3)(f).

It does not cover the auditors's approach to the audit of an insurer, an authorized insurance broker or an approved body of insurance brokers or ~~their~~ routine audit reporting responsibilities.

711. Certain expressions used in the Ordinance may be matters for legal interpretation. There may, therefore, be circumstances in which, notwithstanding the guidance in this Practice Note, the auditors will wish to take legal advice.

Reporting under the Ordinance

812. The Insurance Authority expects that the management of an insurer or an insurance broker will continue to be its primary source of information and that the normal authorized reporting procedures, including returns, discussions, examinations and any tripartite meetings will normally provide the Insurance Authority with most of the information it needs to carry out its responsibilities under the Ordinance.

913. Nevertheless under the Ordinance the auditors ~~has~~ve various statutory responsibilities to report to the Insurance Authority. They auditor ~~is~~are automatically protected in making a report in discharge of such a statutory responsibility. Certain provisions also provide the auditors with immunity from any liability they auditor might otherwise incur by reason of ~~their~~ the auditor's making other reports to the Insurance Authority which they auditor may consider to be relevant to the functions of the Insurance Authority. These responsibilities and avenues available for reporting do not require the auditors to change the scope of ~~their~~ audit work, nor the frequency or timing of ~~their~~ visits.

140. When the circumstances where reporting may be appropriate are being considered, it should be noted that obtaining insurance services or products carries inherent risks. It is not the purpose of the Ordinance, nor the duty of the auditors, to protect the policy holder from the normal risks relating to such activities.
154. The auditors ~~are~~ is advised to bear in mind that their auditor's decision may have to stand up to examination at a future date on the basis of the following considerations:
- a. what they auditor knew at the time;
 - b. what they auditor should have known in the course of their audit;
 - c. what they auditor should have concluded; and
 - d. what they auditor should have done.

The Auditors's notices to the Insurance Authority under section 15A(2)

162. ~~The a~~ Auditors ~~has~~ ve a statutory duty to give immediate written notice to the Insurance Authority in the circumstances set out below.
- a. If they auditor resigns (section 15A(2)(a)).
 - b. If they auditor decides not to seek reappointment (section 15A(2)(b)).
 - c. If they auditor decides to add a qualification or adverse statement to their auditor's report annexed to the financial information of the insurer required to be submitted under the Third Schedule (section 15A(2)(c)).

The decision to give written notice would normally only be taken after extensive discussions with management and when a problem is either irremediable or when the circumstances indicate that the auditors intends to qualify.

Section 15A(2) applies to the auditors of an insurers appointed under section 15 or section 4(1A) of Part 1 of the Third Schedule.

Ad hoc reports under section 53E

173. Section 53E provides that where an auditor, during the performance of ~~his~~ the duties in that capacity:
- a. becomes aware of any matter... which in ~~his~~ the auditor's opinion adversely affects the financial condition of the insurer to a material extent, ~~he~~ the auditor shall, as soon as practicable thereafter, send to the Insurance Authority a report in writing of the matter (section 53E(1)); and
 - b. becomes aware of evidence...
 - i. of a failure by the insurer to comply with any conditions imposed under section 8(1)(a);
 - ii. that there exists a ground on which the Insurance Authority would be prohibited by section 8(3)(a), (b), (d) or (f) from authorizing the insurer if the insurer were to make application in that behalf;
 - iii. of a failure by the insurer to comply with any of the provisions of section 22, 22A or 23; or

- iv. of any default of the insurer in complying with any requirement under section 27, 28, 29, 30, 31, 32, 33, 34 or 35(1),

~~he~~ the auditor shall, as soon as practicable thereafter, send to the Insurance Authority a report in writing of the failure, ground or default (section 53E(3)).

Section 53E applies to:

- a. an auditors or former auditors of an insurers or a former insurers appointed under section 15 or section 4(1A) of Part 1 of the Third Schedule; and
- b. an accountants or former accountants of an insurers or a former insurers appointed in compliance with a requirement under section 35(1).

These are statutory obligations and the following paragraphs of the Practice Note provides the auditors with procedures to follow when such circumstances arise.

Reporting criterion under section 53E

184. The auditors would take the initiative and ensure that an ad hoc report under section 53E is made to the Insurance Authority if the conditions specified in paragraph 173 exist. A distinction must be drawn here between an auditor's duty as stated in paragraph 173(a) and that stated in paragraph 173(b). The duty under paragraph 173(b) is clear and unequivocal; if the auditor becomes aware of a contravention of the provisions in the Ordinance which are specified, they auditor areis not given any latitude for exercising judgement. They auditor are is obliged to make a report. The duty under paragraph 173(a) is different. They auditor areis given the right to form an opinion based on applying criteria as to the materiality of an adverse effect on the insurer's financial position in deciding whether reporting would be appropriate.

The HKICPA has developed a criterion for use by the auditors in deciding to take the initiative in making an ad hoc report under section 53E in addition to their regular audit reporting responsibilities. The criterion is that the auditors would make their report when they auditor considers it expedient to do so in order for the Insurance Authority to protect the interests of policy holders because there has been a material loss or there exists a significant risk of material loss.

195. This criterion can be more fully explained as follows:
- a. there must be a significant adverse occurrence or a change in the auditor's perception of an existing situation, that may include an adverse change in the circumstances of the business; and
 - b. the situation described in a. above has given rise to or has indicated that a reasonable probability exists that it may give rise to:
 - i. a material financial loss to the business, or
 - ii. loss of control over the assets or records.

4620. Examples of the circumstances in which the situation set out in paragraphs 184 and 195 may be met include:

- a. the auditor discovers a failure by the insurer to comply with the relevant provisions of the Ordinance which may have material consequences; or
- b. there is evidence of imminent financial loss of serious proportions which might cast doubt on the continuing viability of the insurer.

Reporting procedures under section 53E

4721. In circumstances where the auditors concludes that an ad hoc report under section 53E to the Insurance Authority is necessary, they auditor would normally adopt the procedures set out below, bearing in mind that speed may be of the essence and that their statutory obligation to report under section 15A or 53E remains subject to the criterion discussed in paragraphs 184 - 4620.
- a. The auditors would normally discuss the matter with the insurer and explain their statutory duty to make a report to the Insurance Authority under section 53E. In addition, the insurer may be advised to make its own report to the Insurance Authority immediately.
 - b. The auditors would normally then immediately inform the Insurance Authority of the circumstances in writing. It is suggested that a copy of both the written notification and their ad hoc report be made to the directors or management of the insurer.
4822. The auditors ~~are~~ is reminded that making an ad hoc report alone may not discharge all their responsibilities. For example, they auditor would consider the implications of the matter giving rise to the ad hoc report for their auditor's opinion on the financial statements.

Other ad hoc communications by the auditors

Statutory protection under section 53D

4923. Section 53D provides that:
- "(1) No duty which a prescribed person may be subject to shall be regarded as contravened by reason of his communicating in good faith to the Insurance Authority, whether or not in response to a request made by the Insurance Authority, any information or opinion on a matter:
- a. of which he becomes aware in his capacity as a prescribed person...; and
 - b. which is relevant to any function of the Insurance Authority under this Ordinance.
- (2) For the avoidance of doubt, it is hereby declared that a matter referred to in subsection (1) may be a matter which relates to a person other than an insurer or former insurer."
240. For the purposes of section 53D, "prescribed person" in this context refers to:
- a. an auditors or former auditors of an insurers or a former insurers appointed under section 15 or section 4(1A) of Part 1 of the Third Schedule;
 - b. an accountants or former accountants of an insurers or a former insurers appointed in compliance with a requirement under section 35(1); and
 - c. an auditors or former auditors of an insurance brokers or a former insurance brokers appointed under section 72.
254. Section 53D does not lay down any rules nor specify the circumstances in which the auditors ~~are~~ is to communicate any matter to the Insurance Authority. It provides a statutory mechanism whereby the auditors may make matters known to the Insurance Authority without breaching their auditor's duty of confidentiality.
262. This section of the Practice Note contains guidance on the circumstances in which matters (which fall outside those which the auditors ~~are~~ is obliged to report (see paragraphs 162 to 48

22 above)) may be brought to the attention of the Insurance Authority by way of a report with statutory protection. In interpreting this guidance, the auditors ~~are~~is advised to bear in mind the fundamental objectives of the legislation, which are to ensure that the Insurance Authority is able to fulfil its functions summarised in paragraph 54.

273. Confidentiality is an implied term of an auditors's contract with the client, but in certain circumstances and under conditions specified in section 53D it does not prevail, since they ~~auditor~~ are~~is~~ entitled to communicate information or opinions on a matter relating to the business or affairs of the client relevant to the Insurance Authority's functions without the duty of confidentiality owed to the client being regarded as having been contravened.

284. The matters which may be communicated under section 53D are any of those relevant to the Insurance Authority's functions under the Ordinance.

295. Matters which may be reported under the protection of section 53D will only arise in circumstances where the auditors ~~are~~is under no duty to report under section 15A or 53E. Considerable care needs to be taken in disclosing matters arising during any tripartite meeting with the Insurance Authority as the auditors's knowledge of these matters may have been obtained while assisting the Insurance Authority other than in their capacity as the auditors (see paragraph ~~283~~32).

Examples of circumstances in which the auditors may communicate a matter to the Insurance Authority under section 53D include:

- a. the auditors ~~considers~~is policy holders have incurred, or are at significant risk of incurring, a material loss as a result of insurers or authorized insurance brokers carrying on business in a manner that is not fit and proper or that is in breach of the Ordinance;
- b. there is evidence of
 - i. fraud, dishonesty or serious incompetence; or
 - ii. serious failure to observe requirements of the Ordinance or conditions imposed on the insurer or authorized insurance broker by the Insurance Authority;
- c. it has come to the attention of the auditors that the procedures, records or systems fail significantly to comply with, or to demonstrate compliance with, requirements set by the Insurance Authority to which the insurer or authorized insurance broker is subject; and
- d. the position is such that because of a significant risk which is material to the collective interests of policy holders, the policy holders' interests would be better safeguarded if the Insurance Authority were aware of the position, even if only to organise protective action.

3026. Clearly the potential nature of matters which may be reported is very wide, but as explained in paragraph ~~29~~33 this does not, of itself, require the auditors to extend the scope of their work in order to discover matters and it will only be in exceptional circumstances such as those described in paragraph 484 that they auditor may choose to seek statutory protection.

2731. Any protected communication can be made either on the auditors's initiative or in response to a request from the Insurance Authority for information. The auditors would normally cooperate with the Insurance Authority and respond to any requests from the Insurance Authority for information, provided they ~~auditor~~ has~~ve~~ no reason to doubt that the request is relevant to the Insurance Authority's functions. The auditors may communicate a matter to the Insurance Authority with the protection of section 53D regardless of the source of that information, provided they auditor became aware of the matter in their capacity as the auditors of the client and they auditor does so in good faith.

- ~~2832.~~ Matters of which the auditors become aware "in their capacity as the auditors" may not be restricted to those matters identified by ~~them~~ the auditor during the course of the audit work. The auditors may become aware of a matter which is relevant to the functions of the Insurance Authority during the course of their work for the insurer or authorized insurance broker other than audit work or through private discussions on social or other occasions, in which case the information will be known to ~~them~~ the auditor as individuals. In circumstances which suggest that a matter would be reported to the Insurance Authority if knowledge of it had been obtained in their capacity as the auditors, it would be prudent to make enquiries in the course of the audit work in order to establish whether this is the case from information obtained in this capacity. In addition, a matter which is relevant to the functions of the Insurance Authority and which is identified during the course of work for the client by another partner (or member of staff) such as a management consultant or tax partner may be deemed to be known to the auditors (see also paragraph 340). The auditor may follow the guidance set out in HKSA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements"
- ~~2933.~~ The auditors cannot be expected to be aware of all circumstances which, had they the auditor known of them, would have led ~~them~~ the auditor to exercise their right to communicate under section 53D. This section does not require the auditors to change the scope of their audit or other work for the client, nor the frequency or timing of their visits. The auditors ~~has~~ have no obligation to seek out grounds for making a report under section 53D. The section does not place an obligation on the auditors to conduct their work in such a way that there is reasonable certainty that they the auditor will discover a matter upon which the Insurance Authority may need to act. It is only when the auditors ~~do~~ do become aware in the ordinary course of their work of such a matter, or of circumstances which suggest the existence of such a matter, that they the auditor would consider using the protection of section 53D.
- ~~340.~~ The auditors would, however, ensure that ~~they are~~ the auditor is made aware of any other relationships which may exist between any department of their firm and the client which could affect their work as the auditors. The Insurance Authority expects that the auditors will ensure that ~~they the auditor are~~ is informed of all potentially exceptional circumstances (paragraphs 484 and 495) by all other departments within their firm which have a relationship with the insurer or authorized insurance broker. It would, therefore, be prudent for the audit firm to ensure any exceptional circumstances which may give rise to reports under section 53D are brought to the attention of the auditors of the client in order that they the auditor can, if appropriate, make enquiries in their capacity as the auditors to ascertain whether such matters should be reported to the Insurance Authority.
- ~~354.~~ The Insurance Authority recognises that it would not be appropriate for the auditors to report information which they the auditor ~~has~~ have obtained or matters which they the auditor ~~has~~ have identified through their professional relationship with another client, even though the information obtained or the matters identified may relate to an insurer or an authorized insurance broker. However, the Insurance Authority expects an insurer or authorized insurance broker to advise its auditors when it appoints a third party (including another department of the same firm) to review, investigate or report on any aspects of its records and systems and to provide the auditors with copies of reports by such a third party promptly after their receipt. The auditors can, if appropriate, make enquiries in their capacity as the auditors to ascertain whether any findings of the reports should be reported to the Insurance Authority.
- ~~362.~~ It should be noted that section 53D will not provide protection to the auditors where they the auditor could be held to have acted maliciously or in bad faith or if the information reported is outside the scope of that section. The Ordinance does not, therefore, provide complete immunity from all types of legal action by all parties affected, or subsequently affected, by their the auditor's action in reporting to the Insurance Authority. The Auditors would consider taking legal or other professional advice before making the decision about whether, or in what manner, to report and in order, for example, to ensure that the form and content of their report are such as to secure the protection of section 53D and that it only includes relevant material.

373. ~~The Auditors are~~ is protected, however, even if the information which they auditor communicates falls short of proof, or the opinion which they auditor communicates cannot be verified. ~~The Auditors~~ who can demonstrate that ~~they~~ the auditor ~~has~~ ve acted reasonably and in good faith in informing the Insurance Authority of a reportable matter would not be held in breach of duty to their client even if, after an investigation, it were found there was not a matter which needed to be reported. These are areas where the auditors may wish to consider taking legal advice before making a report.

384. Whilst no breach of statutory duty might arise, it should be appreciated that there is no protection given by the Ordinance if the auditors, after becoming aware of an occurrence, fail to report, promptly, or at all, to the Insurance Authority. Furthermore, it should be recognised that speed of reporting is likely to be important in order to enable the Insurance Authority to protect the interests of policy holders.

Meetings with the Insurance Authority

395. As part of the Insurance Authority's system of supervision of insurers or authorized insurance brokers, meetings involving the Insurance Authority, the insurer or authorized insurance broker and its auditors may be called. These meetings may be categorised as "routine meetings" called by the Insurance Authority or "special meetings" which may be called by either the Insurance Authority, or the insurer or authorized insurance broker possibly at the auditors's suggestion.

3640. The agenda for a tripartite meeting between the Insurance Authority, the insurer or authorized insurance broker and the auditors will be prepared by the Insurance Authority and will include items requested by the insurer or authorized insurance broker and auditors and be circulated in advance. ~~The Auditors are~~ is expected to participate fully in tripartite meetings and to have regard to the breadth of the Insurance Authority's functions. Normally, however, it is expected that the auditor will discuss with their client any matter which is to be raised at a meeting with the Insurance Authority, before the meeting is held.

3741. ~~The Auditors~~ would be expected to discuss with the Insurance Authority the affairs of the insurer or authorized insurance broker including, if necessary, information about its policy holders or other companies within the group obtained in the course of that work. However, the Insurance Authority recognises that it would not be appropriate for the auditors to report to the Insurance Authority information about the insurer or authorized insurance broker which they auditor ~~has~~ ve obtained through their professional relationship with another client.

3842. Meetings may be called by the Insurance Authority to assist in its forming a judgement on an insurer or authorized insurance broker. In particular discussions may cover:

- a. the presentation and content of the annual financial statements;
- b. the scope, conduct and outcome of the annual audit;
- c. the scope and outcome of any report made under section 53E;
- d. explanations for, the reasons for and the nature of a qualified report or of a change in a previously reported intention to qualify a report;
- e. any step or course of action which may be necessary in the light of the reports, for example, the commissioning of a more detailed report in a particular area; and
- f. matters raised by the Insurance Authority or those which the insurer or authorized insurance broker or auditors have drawn to its attention since any previous meeting, including how such matters have been resolved to the satisfaction of the auditors or have been reflected or treated in the financial statements.

~~3943.~~ Any party may seek to call a tripartite meeting at any other time if important matters affecting the insurer or authorized insurance broker come to their attention as further discussed in paragraph ~~454~~. Normally, the auditors would raise ~~their~~the concerns with the insurer or authorized insurance broker first and if the problem cannot be resolved to ~~their~~ auditor's satisfaction, suggest that the insurer or authorized insurance broker asks the Insurance Authority to convene a meeting.

~~440.~~ In exceptional circumstances, for example, those outlined in paragraphs ~~484~~ and ~~495~~, the auditors may consider it necessary to have a bipartite meeting with the Insurance Authority to discuss the affairs of the insurer or authorized insurance broker or to draw the attention of the Insurance Authority to information about the insurer or authorized insurance broker without its knowledge. Before doing so, however, the auditors would consider taking timely legal advice and whether a representative of the insurer or authorized insurance broker at an appropriately senior level would be informed and invited to attend the meeting.

Reporting via the insurer or authorized insurance broker

~~454.~~ Where the auditors ~~becomes~~ aware of a matter which, in ~~their~~ the auditor's professional judgement, ~~they~~ auditor considers is not required to be reported under section 15A or 53E but ought to be reported to the Insurance Authority, ~~they~~ auditor would consider the facts and, unless inappropriate in the circumstances (described in paragraph ~~484~~), discuss the matter with the management.

~~462.~~ It is important for the auditors to act in a manner that will maintain ~~their~~ professional relationship with ~~their~~ client. Normally, therefore, the auditors would ask the insurer or authorized insurance broker to draw matters about which ~~they~~ auditor ~~are~~ is concerned to the attention of the Insurance Authority. An example of the circumstances under which the auditors ~~are~~ is not required to report but about which ~~they~~ auditor might wish to persuade ~~their~~ client to inform the Insurance Authority are where ~~they~~ auditor forms the opinion that management has reported materially misleading financial information to the Insurance Authority or ~~becomes~~ aware that management has failed, or does not intend, to report something and the failure to report is, or would be, materially misleading.

~~473.~~ Where the insurer or authorized insurance broker will not himself inform the Insurance Authority of a matter, having been advised to do so by the auditors, or where it has not been done within the period of time specified, or where there is not adequate evidence that the client has properly reported the matter in question, the auditors would make such a report direct to the Insurance Authority.

Reporting direct to the Insurance Authority

~~484.~~ In exceptional circumstances, where the auditors ~~doubts~~ whether management are fit and proper persons to carry on the business of insurance and it would be in the interest of protecting policy holders that the management of the insurer or authorized insurance broker should not be informed in advance, the auditors would report directly to the Insurance Authority after first considering the appropriateness of taking independent legal advice. Examples of such circumstances include:

- a. where there has been an occurrence which causes the auditors no longer to have confidence in the integrity of the directors or senior management, e.g. where ~~they~~ auditor believes that a fraud or other irregularity has been committed by the directors or senior management of the insurer or authorized insurance broker, or ~~they~~ auditor ~~has~~ has evidence of the intention of directors or senior management to commit such a fraud or other irregularity; or
- b. where there has been an occurrence which causes the auditors no longer to have confidence that the directors or senior management will conduct the business of the insurer or authorized insurance broker in a prudent manner so as to protect the interests of policy holders, e.g. where ~~they~~ auditor ~~has~~ has discovered that the directors or senior management are acting in an irresponsible or reckless manner with respect

to the affairs of the business or its policy holders, or they auditor ~~has~~ve evidence of their inclination so to act.

495. The auditors would also report directly to the Insurance Authority when speed is of the essence. For example, when they auditor becomes aware that the insurer or authorized insurance broker may be about to cease being authorized, the auditors would consider the need to disclose to the Insurance Authority any information in their auditor's possession relevant to its functions without delay. The fact of such impending cessation of authorization may bring forward the desirability of disclosing matters to the Insurance Authority, as it is easier for the Insurance Authority to take appropriate action while the insurer or authorized insurance broker is still authorized, particularly where such matters have a bearing on the security of third party interests.

Communications by the Insurance Authority to the auditors under section 53A(3)(da) and (3)(f)

4650. The Ordinance also deals with communications by the Insurance Authority to the auditors of an insurers, an authorized insurance brokers or an approved body of insurance brokers.

- a. Section 53A(3)(da) permits the communication of restricted information to the auditors of an insurers or authorized insurance brokers for the purpose of enabling or assisting the Insurance Authority to discharge its functions under the Ordinance without the consent of the person from whom it is received or to whom it relates.
- b. Section 53A(3)(f) permits the communication by the Insurance Authority to the auditors if, in the opinion of the Insurance Authority, such information is necessary for the auditors to perform their duties under the Ordinance.

4751. It should be noted that disclosure by the Insurance Authority of confidential information to the auditors is to them auditor only; they auditor ~~are~~is not free to pass that information to others, such as ~~the~~the client insurer or authorized insurance broker without the consent of the Insurance Authority under section 53A(3D) of the Ordinance.

4852. The Insurance Authority has indicated that it will take the initiative in reporting any matter to the auditors of an insurer or authorized insurance broker under the provisions of section 53A(3)(da) and (3)(f), where it believes that it is of such importance that the auditors's knowledge of it could significantly affect the form of their audit report or the way in which they auditor carries out their reporting responsibilities. The Insurance Authority has also indicated that it will inform the auditors whether the management of the insurer or authorized insurance broker has been informed of the matter and, if so, who has been advised.

4953. In the absence of any notification, the auditors ~~are~~is entitled to assume that the Insurance Authority has considered the need to take such an initiative and has concluded that it has no matters to report to the auditors of an insurer or authorized insurance broker. Accordingly there is no need for the auditors to request the Insurance Authority to confirm this.