

Common issues relating to “certification letters” issued by practitioners

Practitioners in Hong Kong often undertake compliance engagements involving regulated entities (such as those regulated by the Hong Kong Monetary Authority, the Securities and Futures Commission and the Insurance Authority, etc.) which are not audits or reviews of financial statements.

Some practitioners issue “certification letters” for compliance engagements as requested by their clients to assist them in their reporting to regulators. This article discusses two areas of issues concerning “certification letters” (letters or reports issued by practitioners) where the practitioner is requested to undertake an engagement reporting on applicant insurance brokers’ compliance with the minimum requirements set by the

Insurance Authority. These are:

- (i) Form and content of reporting; and
- (ii) Evidence gathering procedures.

Form and content of reporting

There are three common issues concerning the form and content of reporting in the previous examples.

Reporting framework

The wording reflected in the examples is not uncommon for such engagements.

However, the extracts indicate that the related reports do not comply with the framework of *Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*, which

requires compliance with relevant Hong Kong Engagement Standards. The practitioners from the examples should have identified the reporting framework that was applicable to the work they performed and issued a report that would comply with the requirements of the relevant standards. The Hong Kong Engagement Standards are:

- Hong Kong Standards on Auditing;
- Hong Kong Standards on Review Engagements;
- Hong Kong Standards on Assurance Engagements (HKSAEs);
- Hong Kong Standards on Investment Circular Reporting Engagements; and
- Hong Kong Standards on Related Services.

Scope of work

The examples reflect situations in which practitioners were engaged by applicant insurance brokers to issue reports on compliance with the minimum requirements set by the Insurance Authority. The purpose of the engagements was to support the brokers’ applications for membership to the two approved professional bodies of insurance brokers.

The scope of work performed and the types of reports issued by a practitioner are interrelated. However, in the examples, the scope of work was not stated.

Without reference to the scope, confusion could arise when “certification letter” users read the contents. The wording contained in the letters might be open to interpretation. In the “worst case” scenario, readers may believe that the practitioner is providing absolute assurance on the subject matter reported.

The engagements should have been

The following examples are extracted from “certification letters” issued by practitioners on engagements involving applicant insurance brokers’ compliance with minimum requirements set by the Insurance Authority.

Example one

“I am the auditor of the above-named company.

According to the information contained in my client’s accounting records, I would like to confirm as at [date]:

1. The company has a fully paid up capital of HK\$100,000 and has a net worth of not less than HK\$100,000...”

Example two

“I hereby certify that the paid up capital and net asset value of the company as at [date] has fulfilled the minimum requirements of HK\$100,000...”

Example three

“We are newly appointed as the auditors of the captioned company.

On behalf of our client, we have examined the records of the captioned company and would like to certify and confirm the followings:

1. The company has a fully paid up share capital of at least HK\$100,000 and has a net asset value of not less than HK\$100,000...”



undertaken as limited assurance engagements in accordance with HKSAE 3000 (Revised), with reference to Practice Note (PN) 810.1 (Revised) *Insurance Brokers – Compliance with the Minimum Requirements Specified by the Insurance Authority under Sections 69(2) and 70(2) of the Insurance Ordinance*.

With reference to the guidance in PN 810.1, practitioners should understand that the reporting requirements on the engagement subject matter in the examples were the same as those pertaining to insurance brokers' continual compliance with the minimum requirements under section 73 of the Insurance Ordinance. The issued reports should have been aligned with the example in Appendix 3 for unmodified limited assurance reports. Further reference should be made to Appendix 5 for modified wording if the insurance brokers had not complied with the minimum requirements.

Problematic words

In the examples, the practitioners used "confirm" or "certify" or even both in their reports.

Sometimes the words are more problematic than the engagement itself. "Confirm" and "certify" usually suggests "complete accuracy."

In general, a practitioner is not in a position to provide absolute certainty on a matter which is inherently uncertain or judgmental. It is virtually impossible to eliminate risks and provide absolute assurance in these types of engagements. Practitioners should avoid using words or phrases such as "we certify" or "we have ensured" for assertions that can never be made with absolute certainty.

"Examine" is another example of a problematic word, as it is likely to mislead "certification letter" users regarding the extent of work performed. Thus, the engagement letter and report should clearly communicate the scope of work involved in "examining" financial information to avoid any misunderstandings.

"Verify", "check", "correct", "accurate", "review" and "audit in full" are other examples of problematic words that practitioners may consider avoiding the use of the words in their reports on such compliance engagements. Practitioners should make reference to the examples and guidance in relevant pronouncements.

Evidence gathering procedures

The above examples also involved deficiencies in evidence gathering procedures carried out by the practitioners, as described below.

Example one

The share capital of the applicant insurance broker, as reflected in the company's subsequent audited financial statements and Return of Allotments, only increased from HK\$10 to HK\$100,000 almost one year after the "certification letter" was issued.

When issuing the "certification letter," the practitioner accepted a copy of the Return of Allotments, which was yet to be filed with the Companies Registry; board minutes recording the resolution for allotment of shares; and deposit slips of funds from shareholders, as evidence to support his conclusion on the subject matter.

As the relevant shares of the company were not yet allotted to its shareholders at the date of the "certification letter,"

the evidence relied on by the practitioner was essentially not sufficient to support that the applicant had met the minimum requirement on share capital, i.e. the paid up share capital of the applicant should be at least HK\$100,000.

Example two

The share capital of the applicant insurance broker was only HK\$10,000 as reflected in the company's subsequent annual return and was increased to HK\$100,000 nine months after the "certification letter" was issued.

When issuing the "certification letter," the practitioner was aware that the share capital of the client was only HK\$10,000 and that procedures for increasing the paid up capital to HK\$100,000 were being handled by the client's legal consultant. However, the practitioner accepted a draft Return of Allotments and draft board minutes provided by the client as evidence to support his conclusion on the subject matter.

Essentially the draft documents only reflected the client's intention to increase the paid up capital. The practitioner therefore failed his duty to properly report on the subject matter.

Example three

At the date of the practitioner's "certification letter," the applicant insurance broker had a net liability financial position.

When issuing the "certification letter," the practitioner accepted the client's net asset value computation in which a shareholder's loan was reclassified as capital so that the net asset value of the client exceeded HK\$100,000. The practitioner was aware that the shareholder's loan had



Tips for practitioners

Practice Notes and other pronouncements issued by the Institute provide guidance on various supplemental reporting requirements for entities regulated by the Hong Kong Monetary Authority, the Securities and Futures Commission and the Insurance Authority.

When a particular reporting requirement is covered by a specific pronouncement issued by the Institute, that pronouncement should be followed.

In other situations, depending on the circumstances, the scope of work and related report may need to be discussed and agreed. Once the scope of work has been agreed and the relevant professional standards have been identified, the practitioner should:

- Adhere to the agreed scope of work;
- Comply with the applicable requirements of the relevant standards; and
- Ensure that the form and content of his report are appropriate and compliant with the applicable standards.

This helps ensure that the quality of the practitioner's work meets the relevant standards and appropriately addresses the scope of work agreed with the client. This also helps to reduce the risk of an expectation gap between the client, user of the report and the practitioner as to the nature of the engagement being performed, and the level of assurance (if any) being provided by the practitioner.

not been capitalized when the "certification letter" was issued.

Actual allotment of the relevant shares took place approximately one year after the "certification letter" was issued. As the evidence relied on by the practitioner only reflected the client's intention to capitalize the shareholder's loan, the practitioner failed his duty to properly report on the subject matter.

All of the "certification letters" issued by the practitioners in the examples contained inaccurate and/or misleading statements and regulatory actions were taken against the practitioners for their deficient reports.

Guidance

An insurance broker is required to either obtain authorization from the Insurance Authority under section 69 of the Insurance Ordinance or become a member of an approved body of insurance brokers. An applicant insurance broker must comply with the minimum requirements specified under section 69(2) of the ordinance. Failure to comply with the minimum requirements may result in an insurance broker not being authorized or having their authorization withdrawn.

In order to provide limited assurance on an insurance broker's compliance with the minimum requirements, the practitioner should obtain sufficient, appropriate evidence, as set out in paragraphs 48 to 60 in HKSAC 3000 (Revised). PN 810.1 contains recommended procedures for reporting on compliance with the minimum requirements.

The practitioner should always exercise professional judgment in determining the necessary procedures for each individual engagement.

If there is evidence that the insurance

broker has not complied with minimum requirements, the practitioner's responsibilities extend no further than stating in the practitioner's report that there is a lack of compliance with minimum requirements. Appendix 5 of PN 810.1 contains examples of suggested report wording when an insurance broker has not complied with the minimum requirements.

A reminder

The Insurance Companies Ordinance (Cap. 41) was renamed "Insurance Ordinance" when section 4 of the Insurance Companies (Amendment) Ordinance 2015 came into operation on 26 June 2017.

The Insurance Companies (Amendment) Ordinance 2015 is being introduced in phases. The Insurance Authority is expected to take over the regulation of insurance intermediaries from the three self-regulatory organizations (i.e. the Insurance Agents Registration Board established under the Hong Kong Federation of Insurers, the Hong Kong Confederation of Insurance Brokers, and the Professional Insurance Brokers Association) through a statutory licensing regime within two years from 26 June 2017. The self-regulatory system for insurance intermediaries will continue in the interim. Hence, there is no change to the section numbers in the Insurance Ordinance (effective on 26 June 2017) for the relevant sections mentioned in PN 810.1 in the interim.

The Institute is in the process of updating PN 810.1 and the updated practice note will be issued after due process. Practitioners should make relevant changes to the name of the ordinance and the title of PN 810.1 when issuing reports in the interim.



This article is contributed by the Institute's Compliance Department.