



23 January 2019

Our Ref.: C/AASC

Insurance Authority  
19<sup>th</sup> Floor, 41 Heung Yip Road  
Wong Chuk Hang  
Hong Kong

Dear Sir/Madam,

**Consultation Paper on the Draft Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules ("Rules")**

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only statutory licensing body of accountants in Hong Kong responsible for the professional training, development and regulation of the accountancy profession. The HKICPA sets auditing and assurance standards, ethical standards and financial reporting standards in Hong Kong. We welcome the opportunity to provide our comments on the captioned Consultation Paper.

We are supportive of the Rules prepared by the Insurance Authority ("IA") for the new regulatory regime for insurance broker companies. We note that the Rules are chiefly modelled on the relevant requirements set out in the current Guideline on Minimum Requirements for Insurance Brokers issued by the IA under the extant self-regulatory regime, and the IA has proposed refinements on relevant minimum amounts of share capital, net assets and professional indemnity insurance.

Our comments are mainly on the Rules which have accounting or auditing implications. One of our key comments relate to the clarification of the definition of "applicable accounting standards" under which a licensed insurance broker company should be preparing its financial reports. Another key recommendation is around the Draft Rule 8(2) where we believe a conflict with Hong Kong Financial Reporting Standards (HKFRS) implicit in the current proposed text must be avoided. The recognition of financial assets and liabilities before the insurance broker has an associated right and obligation to do so is a clear principle in HKFRS 9 *Financial Instruments* and it must be respected in the accounting for the insurance broker's collection and disbursement activities of client money.

Additional disclosure for information relevant to the IA such as premiums that are due to the insurer but not yet collected by the insurance broker could be required for inclusion in the notes of financial reports prepared under HKFRS even if they do not meet the definition of a financial asset under HKFRS 9. However, the basis for such disclosure must be stipulated in the Rules unless it can be based directly on HKFRS definitions and requirements. The current draft of Rule 8(2) does not appear to be conducive of this clarity and our recommendation is to address the potential ambiguity with an alternative text that we have provided in the Appendix to this letter.



In addition, we would like to seek clarification and highlight some differences in the terms used in the Rules and the accounting standards and their impact on the capital requirements for insurance brokers.

Other detailed comments on the Rules are included in the Appendix of this letter.

We trust that our comments are of assistance to the IA in finalising the Rules. If you require any clarification on our comments, please do not hesitate to contact our Selene Ho, Deputy Director at [selene@hkicpa.org.hk](mailto:selene@hkicpa.org.hk).

Yours faithfully,

Chris Joy  
Executive Director

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## Appendix

### Detailed comments on the Rules

#### Applicable accounting standards

1. Rule 2(1) interprets "applicable accounting standards" to mean
  - a) if the company is incorporated in Hong Kong, the accounting standards generally accepted in Hong Kong; and
  - b) if the company is a non-Hong Kong company as defined in section 2(1) of the Companies Ordinance (Cap. 622), the accounting standards generally accepted in Hong Kong or in the company's jurisdiction of incorporation, as the company may select.

By reference to section 380(8)(a) of the Companies Ordinance (CO) and section 2 of the Companies (Accounting Standards (Prescribed Body)) Regulation, the accounting standards generally accepted in Hong Kong will be those issued by the HKICPA, namely, the Hong Kong Financial Reporting Standards (HKFRS), Hong Kong Financial Reporting Standard for Private Entities (HKFRS for PE) and Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (SME-FRS/FRS).

Please note that SME-FRS/FRS is not a fair presentation framework and accordingly, auditors would not be able to opine on whether the financial reports prepared under SMR-FRS/FRS give a true and fair view. The IA may wish to clarify in the Rules whether insurance broker companies should be preparing financial reports under the HKFRS framework only, or whether reports prepared under HKFRS for PE are also possible. If insurance broker companies are considered publicly accountable entities (which are defined in Hong Kong accounting standards to include entities that hold assets in a fiduciary capacity for a broad group of outsiders as its primary business), they should be required to prepare HKFRS financial reports and not the latter Hong Kong accounting standards. If IA agrees that brokers are publicly accountable entities, then the definition of "applicable accounting standards" should be amended to state clearly that HKFRS are to be required.

#### Net assets

2. Rule 4(2) states that the amount of net assets is to be calculated by excluding all intangible assets. The HKICPA would like to highlight that with new HKFRS 16 *Leases*, effective from 1 January 2019, requires entities to recognise on their balance sheet with entity's lease obligations and corresponding right to use with underlying asset being leased. The right of use of asset would be considered as intangible asset. We suggest the IA make it clearer in the Rules that the definition of intangible assets is limited to the intangible assets defined under Hong Kong Accounting Standard (HKAS) 38 *Intangible Assets* and that the right of use of assets and lease obligations under HKFRS 16 shall not be excluded from the calculation of the net assets for capital requirements purposes.

### **Professional indemnity insurance**

3. Rule 5(5) states that the deductible amount under the professional indemnity insurance policy must not be more than 50% of the company's net assets as at the end of its financial year immediately preceding the date of commencement of PII cover. It is unclear whether the company's net assets amount is based on management accounts or the audited financial statements.

### **Client account**

4. Rule 6(10)(b) states that a reconciliation statement is required to be prepared with the cause of the difference shown by each of the comparisons. It is not very clear what is meant by "each of the comparisons"? Moreover, there is no particular guidance on the action to be taken if differences are identified, for example, should the broker make a payment into or out of the client bank account within a fixed period of time? We suggest the IA to clarify and issue guidance where appropriate.
5. HKFRS have principles for when an entity should recognise an asset or a liability as defined by the standard and this may include amounts related to that client account. The IA may consider adding a paragraph that alerts brokers to ensure they adhere to the accounting standards when accounting for items in client accounts.
6. We welcome the IA's proposed additional measure to require an insurance broker company to carry on a monthly reconciliation exercise to enhance policy holder protection. However, it is not clear from the Rules whether an insurance broker company is required to demonstrate effective controls of its client account management. To reinforce the importance of safeguarding and protecting policy holder funds, we would suggest the IA considers including an overarching requirement for an insurance broker company to implement effective internal controls for client asset management.

### **Keeping of proper books and accounts, audited financial statements and auditor's report**

7. The terms "profit and loss accounts", "income and expenditure accounts" and "balance sheets" used in Rules 7, 8 and 9 for the main statements of financial statements are not consistent with those used in the Hong Kong accounting standards. We recommend that all terms that will be used in the Rules are amended to be identical to the terms that are already stipulated in HKICPA issued guidance and the Hong Kong legislation on the preparation and audit of financial statements. We have highlighted below those instances where such inconsistency is present in the Rules.
8. Rule 8(1) requires that the audited income and expenditure account provided by a licensed insurance broker company must include insurance brokerage income for general business and long term business, referral income and expense. It is stated in Rule 9(1) and section 73(1) of the extant and amended Insurance Ordinance that an insurance broker is required to give IA a copy of the audited profit and loss account, a copy of the audited income and expenditure account and a copy of the



audited balance sheet. According to Rule (2), if the insurance broker is incorporated in Hong Kong, the applicable accounting standards are accounting standards generally accepted in Hong Kong.

In general, the financial statements of Hong Kong incorporated companies are prepared in accordance with financial reporting frameworks issued by HKICPA, e.g. HKFRS, HKFRS for PE. We would like to highlight that the statements specified in Rule 9(1) and section 73(1) are not aligned with the statements set out in HKFRS and HKFRS for PE. For example, according to HKAS 1 (Revised), *Presentation of Financial Statements*, there is no differentiation of "profit and loss account" and "income and expenditure account", it is generally titled "statement of profit or loss and other comprehensive income" and "balance sheet" may also be titled "statement of financial position".

Please find the links to [HKAS 1 \(Revised\)](#), [HKFRS for Private Entities](#) for presentation of financial statements and [Hong Kong Standard on Auditing 700 \(Revised\)](#), [Forming an Opinion and Reporting on Financial Statements](#) for illustrations of auditor's reports for your reference.

9. Rule 8(2) states that the audited balance sheet must include (a) aggregate balances of its client accounts; (b) insurance premiums receivable; and (c) insurance premiums payable. As insurance intermediary, it may not be appropriate for the insurance broker to recognize insurance premiums receivable and payable as a result of the consideration of risk and rewards of the premiums receivable. Such requirement of disclosures may not be consistent with the existing accounting treatment for insurance brokers. As currently drafted Rule 8(2) could produce conflicting guidance for insurance brokers and its auditors and we recommend to change it as follows:

- (2) *The audited balance sheet financial statements provided by a licensed insurance broker company under section 73(1)(c) of the Ordinance must include a disclosure note of the licensed insurance broker company's –*
- (a) *aggregate balances of cash held in its client accounts;*
  - (b) *aggregate balances of the amounts due to the issuers of the contracts of insurance that the insurance broker company placed; and*
  - (c) *aggregate balances of the insurance premiums receivable as a result of the issuance of a premium due notice to policyholders and for which the insurance broker has the obligation to collect the premium for the issuer of the contract of insurance.; and*
  - (d) *insurance premiums payable.*

10. Rule 9(1) refers to true and fair view opinion on "income and expenditure" for its financial year as well "profit and loss" and "state of the company's affairs". For licensed insurance broker companies incorporated in Hong Kong, they are also required to comply with the requirements in the CO for the preparation of financial statements. Please note that under section 406(1) of the CO refers to "financial position" and "financial performance" of the company.

We have extracted section 406(1) for your reference.

**"406. Auditor's Opinion on Financial Statements, Directors' Report, etc.**

- (1) An auditor's report must state, in the auditor's opinion –
- (a) whether the financial statements have been properly prepared in compliance with this Ordinance; and
  - (b) In particular, whether the financial statements –
    - (i) In the case of annual financial statements of a company that does not fall within the reporting exemption for the financial year, give a true and fair view of the financial position and financial performance of the company as required by section 380; ..."

We suggest the IA to consider clarifying in the Rules that for such licensed insurance broker companies, the audited financial statements prepared in accordance with the CO would meet the requirements under the Insurance Ordinance.

11. Rule 9(2) states that the auditor's report under section 73(1)(e) must contain statements stating whether, in the auditor's opinion, the company has continued to comply with the relevant requirements as at the end of the financial year and two other selected dates. Under the extant "Guideline on Minimum Requirements for Insurance Brokers", the same reporting requirements are set out in paragraph 5(A)(iii), and under the extant 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*, the auditors provide a limited assurance in their report under Hong Kong Standard on Assurance Engagements 3000 (Revised) "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" for this reporting. We believe that there is no intention to change the scope of the reporting and the extant limited assurance report will fulfil the reporting requirements under Rule 9(2) and section 73(1)(e).

**Savings and Transitional Arrangements**

12. Schedule 1 Section 4 exempts an insurance broker from preparing client monies reconciliation for the first 6 months after the commencement date. It is unclear why such exemption is considered necessary.