QUALITY ASSURANCE FORUM

Practice review - common myths and findings

September 2013
Agenda

- Institute Quality Assurance activities
- Practice review outcomes in the past five years
- Top ten myths about practice review
- Top ten common findings identified in practice review
- Special topic - audit of insurance brokers
- Q&A session
Institute Quality Assurance activities

- Professional standards monitoring
- Practice review
Professional standards monitoring

- Reviews Hong Kong listed company financial statements including some prepared under CASBE
- Regular communication with HKEx and the FRC to avoid duplication of reviews
- Refer cases to the FRC for investigation if significant non-compliance with standards identified
- Review outcomes for 2012
  - 85 sets of financial statements reviewed
  - 49 enquiry and recommendation letters issued
  - 3 cases referred to the FRC
- Common findings will be covered in the Joint Forum with HKEx and the FRC later this year
Practice review

• Monitor the quality of work of auditors – statutory responsibilities and powers to regulate auditors in Hong Kong under the Professional Accountants Ordinance

• Ensure that all practising members, firms and corporate practices maintain professional standards

• Report to Practice Review Committee – a statutory committee
Practice review outcomes – all practices
Practice review outcomes – all practices

- Directly closed cases increased from 26% in 2011 to 33% in 2012
- Majority still require remedial actions, follow up visits or even disciplinary action
- No significant improvement
- Same common issues continued to be identified
Practice review outcomes – practices with listed clients

Practice review cases reported to PRC (Practices with listed clients)

- Direct closed
- Required follow up action
- Required follow up visit
- Disciplinary action

<table>
<thead>
<tr>
<th>Year</th>
<th>Direct closed</th>
<th>Required follow up action</th>
<th>Required follow up visit</th>
<th>Disciplinary action</th>
</tr>
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<td>2008</td>
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<tr>
<td>2012</td>
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</tbody>
</table>
Practice review outcomes – practices with listed clients

- Directly closed reviews decreased from 62% in 2011 to 40% in 2012
- In 2012, visited six practices with first time listed client engagements
  - four practices needed follow up actions
  - another one practice required a follow up visit
- And the lesson is: listed company audits demand higher level of resources and technical knowledge
Practice review outcomes – other practices
Practice review outcomes – other practices

• Directly closed reviews increased from 21% in 2011 to 32% in 2012
• Required follow up actions decreased from 77% in 2011 to 65% in 2012
  ▪ Still high percentage
  ▪ No significant improvement
  ▪ Same common issues continued to be identified
Past five years outcome – all practices

Initial practice review reported to PRC from 2008 to 2012

- 6% (41 cases) Required follow up visit
- 28% (196 cases) Direct closed
- 56% (470 cases) Required follow up action
- (4 cases) Disciplinary action
Top ten myths about practice review
Top ten myths about practice review

1. A practice review is a fault finding exercise

Fact:
- Link between CO/PAO/SMO 1 makes PR important to uphold creditability of the audit profession
- Revised PR program – constructive, fact finding and educational with positive feedback
- PAO sets out certain specific requirements to be met before a complaint can proceed on a first visit
- Reviewed around 700 practices with 4 complaints in 7 years
- Cannot tolerate practices that continue to fail and will take appropriate regulatory actions if necessary
Top ten myths about practice review

2. Manipulating the answers provided in the EQS is a way to avoid practice review

Fact:
- EQS is main source of information for our selection
- Less reliance on EQS for selecting practices with listed clients (three year cycle)
- Determine risk profile for practices w/o listed clients
- QAD also obtains information from other sources
- QAD also selects a number of practices on a random basis - ensure all have a chance of being selected
Top ten myths about practice review

2. Manipulating the answers provided in the EQS is a way to avoid practice review

Fact (cont'd):
• QAD will prioritize practices if inconsistent information is noted between EQS and other sources
• QAD and the practice review committee will deal robustly with situations where practices deliberately provide untrue information in the EQS
• Integrity is one of the fundamental principles that professional accountants should comply with
Top ten myths about practice review

3. After conclusion of a practice review a small practice will not be selected for another practice review for several years.

Fact:
• PR is not a test but a monitoring process.
• Although conclusion might indicate quality control and audit quality are adequate based on existing clientele.
• If risk profile changes because of changing clientele or not keeping up with standards, a practice will be reconsidered for selection.
• Should always upkeep standards not just polish them for practice review.
Top ten myths about practice review

4. It is acceptable for a small practice to carry out a monitoring review only once every three years

Fact:

- HKSQC1 requirement is not explicit but uses 3 years as an example for an inspection cycle for engagement.
- Requires ongoing evaluation of QC system and communication of results at least annually (HKSQC 1 para 53)
- QAD takes the view that monitoring of policies and procedures (P &P) is needed to be done annually to:
  - provide an analysis of new developments that affect P& P, written independence confirmations, CPD and acceptance & continuance decisions
  - determine corrective actions and improvements, communicate to and follow up by appropriate staff (see HKSQC1 A65)
Top ten myths about practice review

5. In the eyes of a reviewer, a subcontracting arrangement is always problematic

Fact:
• Properly constructed and managed arrangements with subcontractors to fill a gap in resources or skills are not a problem
• Ultimate responsibility for the audit opinion and compliance with standards remains with the practice
• Practices should have control over the subcontractor's work and ensure the work meets the practice's requirements
Top ten myths about practice review

5. In the eyes of a reviewer, a subcontracting arrangement is always problematic

Fact (cont'd):
- Instances where practitioners display little control resulting in poor quality of audit work still occur too frequently (see common findings later)
- "tang zai" and "sampans" arrangements where members collude with unlicensed agents raised concerns
- Subcontracting arrangement is a risk factor in our selection process
- Assessment will be made on how subcontracting arrangement affects quality
- There will be no issue if quality is upheld
Top ten myths about practice review

6. Having a copy of the Institute's A Guide to Quality Control (the "Guide") will show that a practice is serious about quality

Fact:

• Basic requirement is for a practice to have its own quality control manual ("QCM")
• Not mandatory to use the Guide as there are other resources available, e.g. IFAC publications
• QAD assesses and reviews a practice against the requirements of HK SQC 1, not the Guide
• QCM should be tailored to suit a practice's circumstances
• P& P should be properly implemented
Top ten myths about practice review

6. Having a copy of the Institute's A Guide to Quality Control (the "Guide") will show that a practice is serious about quality

Fact (cont'd):
• Sample QCM in the old Guide (new edition issued in June 2013) normally requires tailoring for:
  ▪ Frequency of monitoring review
  ▪ File assembly procedures
  ▪ Use of the EQCR Risk Tolerance Worksheet and the additional checklists of acceptance and continuance assessment
Top ten myths about practice review

7. A reviewer will not challenge a practice that uses the Institute's Audit Practice Manual ("APM") as its audit methodology

Fact:

- A practice should have an audit methodology sufficient to facilitate compliance with professional standards
- APM incorporates standard procedures to facilitate efficient and effective compliance with professional standards but its use is optional
- QAD will assess whether APM is used appropriately
  - Programs and checklists are properly tailored and completed
  - Appropriate comments or references are added to elaborate thought process or details of procedures performed
  - If used selectively, all necessary requirements are addressed in particular HKSA 240, 315, 330
Top ten myths about practice review

8. A reviewer will accept immediate default to a "substantive" approach for a SME client with no apparent controls

Fact:
• Current standards require risk assessment process regardless of the size and complexity of clients
• An auditor needs to understand his client and evaluate design and implementation of controls, incl. management control
• Dependent more on inquiry than review of documents
• Documentation required can be simpler
8. A reviewer will accept immediate default to a "substantive" approach for a SME client with no apparent controls

Fact (cont'd):
• "Substantive" approach alone will not fulfill the requirements of auditing standards
• Risk of material misstatement might not have been appropriately addressed without a risk assessment process
• Opinion might not have been adequately supported
Top ten myths about practice review

9. A disclaimer of opinion will act as a powerful defense for any challenge to the audit work performed

Fact:

- A disclaimer of opinion is not a disclaimer of responsibility
- The principle of due care imposes the obligation to act diligently in accordance with professional standards
  - Unacceptable to use a disclaimer as a substitute for required audit procedures (e.g. attendance at stock take)
  - Unable to justify a disclaimer before completing all necessary work (e.g. to meet tax deadline) or exploring all alternative procedures possible
9. A disclaimer of opinion will act as a powerful defense for any challenge to the audit work performed

Fact (cont'd):
• A disclaimer of opinion does not justify the omission of a description of all identified matters that would have otherwise required a modification of the auditor’s opinion
• Repeated disclaimer of opinion on the same grounds is not appropriate and in such circumstances reappointment should not generally be accepted
Top ten myths about practice review

10. Self monitoring is always an acceptable option for a SMP

Fact:
• HKSQC 1 sets out options for SMPs: use a suitably qualified external monitor or establish arrangements to share resources with other practices
• QAD accept that if there is no other alternative option: self-monitoring by sole practitioner or a suitably qualified and experienced staff member may be sufficient
Top ten myths about practice review

10. Self monitoring is always an acceptable option for a SMP

Fact (cont'd):
• HKSQC 1 requires that those performing the engagement or the engagement quality control review should not be involved in inspecting the engagement
• If practice review findings suggest self monitoring is not effective, practices will be asked to implement other alternative measures (e.g. engage external reviewers)
Top ten common findings

Divided into:

- 5 for practices with listed company engagements
- 5 for practices without listed company engagements
Listed company engagements
Top 1 - Unsatisfactory group audits

What we found:
• No analysis of components to identify those that are significant and no work planned to be performed on component financial information

• No or insufficient audit work on a significant component

• Communications with component auditor not timely or insufficient indicating that the group auditor did not adequately direct and supervise the audit work of component auditor
Listed company engagements
Top 1 - Unsatisfactory group audits

What we found (cont'd):

• Failure or inability to get involved in the work of component auditor on a significant component to the extent necessary to obtain sufficient appropriate audit evidence to support group audit opinion

• No additional procedures in cases where the auditor of a significant component did not fully cooperate

• Audit of a significant component performed by component auditor was completed later than the group's audit report date
Listed company engagements
Top 1 - Unsatisfactory group audits

Ways to do better:
• Identify issues at an early stage e.g. during acceptance and continuance stage

• Engagement letter to cover following matters:
  • Free communication between group auditor and component auditors
  • Permission to access component information, management and auditors
  • Permission to perform work on component financial information or request component auditors to do so
Listed company engagements
Top 1 - Unsatisfactory group audits

Ways to do better (cont'd):

The group auditor should

• Carry out audit of the significant component if other satisfactory arrangements with component auditors are not possible

• Consider modifying the audit opinion on group financial statements if insufficient audit evidence obtained on a significant component

• Read Alert No. 17: Audits of group financial statements – HKSA 600

• Read Alert No. 18: Documentation requirements for group auditors and practical implications for auditor regulation in Hong Kong
Listed company engagements
Top 2 - Over-reliance on professional valuation

What we found:

• Insufficient challenge of the assumptions used by experts
• Not reviewing the appropriateness of valuation methods and assumptions (even when totally unrealistic)

For example:

  ▪ Use of 15 years, 20 years or even longer period of cash flow
  ▪ Revenue growth over the forecast period erratic or bears no relation to past performance
  ▪ Unreasonable valuation (e.g. Land use right valued at ten times more than original cost only a few months after acquisition)
Listed company engagements
Top 2 - Over-reliance on professional valuation

What we found (cont'd):

• Experts' independence and competence not assessed
• Not considering whether additional audit procedures needed in respect of disclaimers made by valuers in their reports
• Some practices are repeat "offenders"
  ▪ Consider that there is no need to carry out any assessments of the experts' work
  ▪ Inappropriate mindset and no commitment
• Some practices consider it is not appropriate to challenge external experts
Listed company engagements
Top 2 - Over-reliance on professional valuation

Ways to do better:

- Engagement partners and EQC reviewers should:
  - Obtain an understanding of the assumptions and methods used and consider whether they are appropriate and reasonable, based on their knowledge of the business and the results of other procedures
  - Consider engaging independent experts and adhere to requirements of HKSA 620 *Using the Work of an Auditor's Expert*
  - Undertake relevant training
Listed company engagements
Top 3 - Inadequate impairment assessment

What we found:
• No justification for using a longer projection period than allowed under HKAS 36 *Impairment of Assets*
• Goodwill acquired in a business combination not tested annually
• Not aware that the DCF should exclude
  ▪ Income tax receipts or payments
  ▪ Borrowing costs
  ▪ Any estimated future cash inflows or outflows expected to arise from future restructurings or from improving or enhancing the asset's performance
Listed company engagements
Top 3 - Inadequate impairment assessment

What we found (cont'd):

• No sensitivity analysis performed to test whether any reasonable change in assumptions would cause impairment issues

• No consideration of potential impairment in respect of:
  ▪ Investments in subsidiaries
  ▪ Material amounts due from subsidiaries (with poor financial position)
  ▪ Intangible assets
Listed company engagements
Top 3 - Inadequate impairment assessment

Ways to do better:

• Establish a well structured and thorough audit methodology and EQC review mechanism
• Engagement partners and EQC reviewers should
  ▪ Gain a good understanding of the requirements of HKAS 36 *Impairment of Assets*
  ▪ Provide appropriate supervision and support for audit staff
• Apply professional scepticism
• Partners/ principals and staff undertake training on HKAS 36
Listed company engagements
Top 4 - Inadequate acceptance and continuance procedures

What we found:
• No consideration of important factors before accepting appointment as auditor of a listed company:
  ▪ Integrity of prospective clients
  ▪ Issues identified by ex-auditor
  ▪ Background search
  ▪ Sufficiency of resources and time to undertake an audit of a listed company
Listed company engagements
Top 4 - Inadequate acceptance and continuance procedures

Ways to do better:

• Carefully consider the practice's ability and resources before accepting or continuing listed, regulated or high risk clients

• Do not accept clients for which the practice has insufficient ability to handle or no past experience of the business in which the potential client is involved

• Based on understanding of the client, allocate appropriate resources (numbers, experience and skills of staff)
Listed company engagements
Top 5 - Lack of professional scepticism

What we found:
• Auditor's professional scepticism - particularly important when addressing areas of the audit that are more complex, significant or highly judgmental
• Not approaching all audits with an appropriate degree of professional scepticism (objectivity and challenge)

Ways to do better:
• Promote and recognise the application of professional scepticism by all staff
• Read Alert No. 16: Alert on professional scepticism and audit of mainland companies
Private company engagements
Top 1 - Unsatisfactory subcontracting arrangements

What we found:

• Potential independence threat due to subcontractors' provision of non-assurance service and involvement in the audit
• Practitioners' lack of involvement in client acceptance and continuance process
• Over-reliance on subcontractors to contact clients during the audits
• Insufficient understanding of clients' business and audit work performed by subcontractors

For example:

 Inability to explain to the practice reviewer the nature of client's business
Private company engagements
Top 1 - Unsatisfactory subcontracting arrangements

Our concerns:

• Subcontractors are not competent
  ➔ Not familiar with professional standards

• No evidence that practitioners reviewed or raised any queries on the subcontractors' work
  ➔ Lack of effective engagement review

• Practitioners were unable to explain how audit procedures were performed or what evidence was obtained
  ➔ Loss of control over audit process
Private company engagements
Top 1 - Unsatisfactory subcontracting arrangements

Ways to do better:
• Seriously consider the "real" need for using subcontractors
• Appropriately supervise and support subcontractors
• Exercise appropriate control over subcontractors
• Terminate subcontracting arrangements with subcontractors that are not competent
• Consider assigning an EQC reviewer to review completed subcontracted engagements if possible
• Ensure subcontracted engagements are subject to monitoring review
Private company engagements
Top 2 - Inappropriate use of modified auditor's opinion

What we found:

• Practices not completing all necessary audit work before concluding a disclaimer of opinion was appropriate.

  For example:
  ▪ The practice claimed that there was insufficient audit evidence to verify major account balances
  ▪ The practice was unable to provide evidence that it tried to perform alternative procedures
  ▪ The practice issued a disclaimer of opinion on most items in the statement of financial position

• Inappropriate use of modified opinions to circumvent necessary audit procedures e.g. stock take
Private company engagements
Top 2 - Inappropriate use of modified auditor's opinion

What we found (cont'd):

- Not considering whether it is appropriate to reaccept the engagement
  - Recurring limitation that require a qualification under HKSA 705
    Modifications to the Opinion in the Independent Auditor's Report
  - Not being able to properly discharge auditors' duties under the
    Code of Ethics for Professional Accountants

Ways to do better:

- Carefully consider the justification and reason before issuing a
  modified auditor's opinion
- Gain a good understanding of HKSA 705
Private company engagements
Top 3 - Insufficient understanding of Clarified Auditing Standards

What we found:

• Some auditors still not conversant with the requirements of Clarified Auditing Standards

• No or limited fraud risk assessment [HKSA 240 (Clarified)]

• Insufficient understanding of
  ▪ client's business [HKSA 315 (Clarified)]
  ▪ the determination of audit materiality [HKSA 320 (Clarified)]
  ▪ the auditor’s responses to assessed risks [HKSA 330 (Clarified)]
  ▪ group audits [HKSA 600 (Clarified)]
Private company engagements
Top 3 - Insufficient understanding of Clarified Auditing Standards

Ways to do better:
• Attend relevant training sessions
• Update and revise audit methodology to comply with Clarified Auditing Standards
• Establish an effective internal training program
  ▪ Ensure the trainer has the right skills to deliver the relevant message
  ▪ Make sure all partners / principals aware of and understand the Clarified Auditing Standards
• Establish an effective monitoring system
Private company engagements
Top 4 - Failure to address independence issues

An example:

- Sole proprietor (no staff, all audit work was performed by the sole proprietor)
- Company A is owned by sole proprietor's friend and provides non-assurance services to the practice's audit clients
- Sole proprietor was substantially involved in the management and daily operations of Company A and paid a salary by Company A
- Company A is an audit client of the sole proprietor
- Any problem?
Private company engagements
Top 4 - Failure to address independence issues

Our concerns:

• Issue 1 – the sole proprietor was involved in management of Company A
  ▪ Resulted in significant independence threat which cannot be reduced to an acceptable level
  ▪ Not comply with the requirements of Code of Ethics

• Issue 2 – sole proprietor was involved in both audit work and non-assurance work for same audit clients
  ▪ No independence assessment of nature of non-assurance work provided by sole proprietor to the audit clients
  ▪ No evidence to show safeguards applied to address potential independence threats
Private company engagements
Top 4 - Failure to address independence issues

Ways to do better:

• Treat all potential independence issues as important matters
• Seriously consider cause of independence issues
• Take immediate actions to address independence issues
• Review and understand the requirements of the Code of Ethics
• Read Ethics Circular 1
Private company engagements
Top 5 - Issues related to audit confirmations

What we found:
• Non-replies were not properly followed up
• Discrepancies between balances on confirmations and ledgers were not properly followed up
• Confirmation requests were not sent out by auditors
• Confirmation replies were not received by auditors
• No verification of the source and reliability of confirmations replied by fax or email

Ways to do better:
• Gain a good understanding of HKSA 505 External Confirmations
Special topic - audit of insurance brokers
Special topic - audit of insurance brokers

AGENDA

• Legal Framework and Minimum Requirements

• Tips for Auditors

• Revised PN 810.1
Special topic - audit of insurance brokers

Legal framework and minimum requirements

Insurance broker - carries on business of negotiating or arranging contracts of insurance as the agent of policyholder.

Insurance broker is required to obtain authorization from Insurance Authority ("IA") under s69 of Insurance Companies Ordinance ("ICO"); or become a member of a body of insurance brokers [Hong Kong Confederation of Insurance Brokers ("HKCIB") and Professional Insurance Brokers Association ("PIBA")]] approved by IA under s70 of ICO.

Auditor is required to issue a compliance report on the following four minimum requirements (i.e. capital and net assets, professional indemnity insurance, keep separate client accounts and keep proper books and accounts.)
Special topic - audit of insurance brokers
Tips for auditors

X Don’t assume that performing normal audit procedures would cover compliance work.

X Don’t simply complete Appendix 1 of PN 810.1 without documenting extent of work done e.g. (1) understanding of the broker’s control over client monies and (2) details of samples selected, etc.
Special topic - audit of insurance brokers

Tips for auditors

√ Do read and understand minimum requirements set out in ICO and guidelines issued by IA, membership rules and regulations of HKCIB and PIBA (which are updated from time to time).

√ Do agree terms of engagement and obtain written representation from management to address specific requirements of compliance reporting.
Tips for auditors

Professional Indemnity Insurance ("PII") Cover

√ Do document how to determine minimum limit of indemnity insurance and what procedures were performed to assess its adequacy (e.g., checking brokerage income against accounting records and actual cover)

Greater of

a) 2 x insurance brokerage income relating to 12 months immediately preceding commencement date of PII cover); or

b) HK$3M;

which up to a maximum of HK$75M

√ Minimum limit = HK$3M, check whether PII policy provides for one automatic reinstatement.

√ Minimum limit > HK$3M, check whether the broker (as a result of a claim) effected a reinstatement to cover up to the minimum limit.
Special topic - audit of insurance brokers (Example)

How to determine minimum limit of indemnity for PII?
Which turnover/period of turnover should it be based on?
Financial year: 1 Jan 2012 to 31 Dec 2012
Commencement date of PII cover: 1 July 2012
Limit of Indemnity: HK$12,000K

<table>
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<th>Turnover HK$000'</th>
<th>12 mths preceding commence date of PII</th>
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<td>Jan to Jun 2011</td>
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<td>Insurance brokerage (A)</td>
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<td>Securities brokerage (B)</td>
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<td>5,000</td>
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<tr>
<td>Total turnover (A+B=C)</td>
<td>4,000</td>
<td>10,000</td>
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</table>
Special topic - audit of insurance brokers (Example)

How to determine minimum limit of indemnity for PII? Which turnover/period of turnover should it be based on?

Option A = 2 \times (HK$4,000K \text{ and } HK$2,000K) = HK$12,000K
2 \times \text{insurance brokerage business income during financial year} \ (\text{No})

Option B = 2 \times (HK$10,000K \text{ and } HK$8,000K) = HK$36,000K
2 \times \text{total turnover of 12 months immediately preceding commencement date of PII cover} \ (\text{No})

Option C = 2 \times (HK$5,000K \text{ and } HK$4,000K) = HK$18,000K
2 \times \text{insurance brokerage income of 12 months immediately preceding commencement date of PII cover} \ (\text{Yes})
Special topic - audit of insurance brokers (Example)

How to determine minimum limit of indemnity for PII? Which turnover/period of turnover should it be based on?

According to Guidelines issued by IA, PII cover is 2 x insurance brokerage income of 12 months immediately preceding the date of commencement of PII cover.

Minimum limit should be HK$18,000K = 2 x (HK$5,000K and HK$4,000K) i.e. 2 x brokerage income from 1 July 2011 to 30 June 2012.

Limit of indemnity set out in PII (HK$12,000K)<Minimum limit (HK$18,000K)

Potential breach of minimum requirements
Follow up question:

Does the above test only need to be performed once every year?

The answer is "Depends".

If there is only ONE policy in effect during f/y, the test need only be carried out once as the result would be the same for any dates selected.

If there is MORE than one policy in effect during f/y, e.g. (1) where the period of cover does not coincide with f/y or (2) where the insurer of the PII changed during f/y, it may be necessary to carry out the test more than once, to evidence the adequacy of insurance cover in force throughout the period (three dates at least) under review.
Revenue recognition according to monthly statements?

Background:
• Broker C recognized insurance commission income according to date of monthly statements received from insurance companies.

Problem & Solution:
• Date of monthly statements did not coincide with date when insurance brokerage services are rendered.

• Auditor should take account of factors such as effective dates of insurance policies, events of non-performance and cancellation of insurance policies.

Applicable guidelines are set out in Appendix of HKAS 18.
Special topic - audit of insurance brokers

Revenue recognition on a gross basis?

Background:

- Broker D recognized income on a gross basis (i.e. showing gross premiums received and receivables as revenue and premium paid to insurance companies as direct expenses in the income statement).

Problem & Solution:

- Since a broker normally acts as an agent, revenue should be recognized on a net basis (i.e. showing insurance brokerage income as a single line item).

Applicable guidelines are set out in Appendix of HKAS 18.
Special topic - audit of insurance brokers

Key revisions to PN810.1 (issued on 30 April 2013)

• Clarified HKSAs

• Compliance with Minimum Requirements - HKSAE 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" (Annex 1)
  ➔ Select 3 dates at a minimum for compliance testing
  ➔ Should include B/S date and two dates at least 3 months apart as stated in Guidelines issued by IA

• Clarification changes - keeping of separate client accounts

• Compliance with Minimum Requirements by constituent members of approved body of insurance brokers - HKSRS 4400.
Special topic - audit of insurance brokers

New procedures in revised PN 810.1

- The following new procedures are not exclusive, please read the revised PN 810.1 (issued in April 2013).

- Any omission of procedures suggested in the PN might affect the compliance opinion. Auditors should ensure that sufficient and appropriate procedures are performed to support the compliance opinion given.
New suggested procedures for PII

• Check whether deductibles (stated in PII policy) exceeds the broker's net asset value (based on latest audited f/s)

Background:

• Deductibles* (set out in PII policy of Broker E): HK$100,000
• Latest audited financial statements: NAV HK$80,000

Problem:

• NAV < Deductibles → Indicates insufficient assets to settle potential claims.

*A deductible is an amount withheld by the insurer from the claim amount paid to the policyholder. In some policies, another similar term, Excess, is used. Excess is an amount a policyholder must bear before liability passes to the insurer.
Special topic - audit of insurance brokers

New suggested procedures for keeping of separate client a/c

• Review Broker’s controls over client monies including reconciliations prepared by Broker
  a) between (1) monies in client a/c, (2) Insurance broking debtors and creditors (at an individual client level) to determine if there is any deficiency in the client a/c
  b) with sufficient regularity

• Scan client a/c for potentially unusual items, e.g. round sum transfers, regular frequent transfers and individually large deposits or transfers.

• In situation where management represents that there is no insurance brokerage activity, e.g. cease of brokerage business, obtain corroborative evidence (e.g. obtain understanding of client's business; scan records of receipts & payments)
Effective date:

- **Prospective application** from April 2013, that is to say for engagements commencing at the time the revised PN is issued (i.e. April 2013).

- For engagements currently underway, or those that relate to a reporting period ended before 30 April 2013, the earlier version of the PN can still be used but the auditor can choose to apply the revised PN.
Questions and Answers