PRACTITIONER SUPPLEMENT

FAQS: AUDITORS REPORTING OBLIGATIONS TO THE CAYMAN ISLANDS MONETARY AUTHORITY AND FINANCIAL REPORTING AUTHORITY

INTRODUCTION

The Mutual Funds Law (section 35), the Banks and Trust Companies Law (section 13), the Insurance Law (section 20), the Companies Management Law (section 13), and the Securities Investment Business Law (section 19) ("the relevant laws") impose on auditors under certain circumstances a statutory reporting obligation to the Cayman Islands Monetary Authority ("CIMA"). In addition, further reporting obligations to The Financial Reporting Authority ("FRA") are prescribed in the Proceeds of Crime Law ("POCL") primarily section 136 and 137.

Further, the IFAC Code of Ethics provides a new pathway to decide how to act when a professional accountant identifies Non-Compliance with Laws and Regulations ("NOCLAR") that comes into effect on July 15 2017. The International Standards of Auditing have been amended to acknowledge NOCLAR and come into effect on December 15 2017.

The objective of this Practitioner Supplement is to provide clarification of the expectations of CIMA and the FRA in respect of the reporting public practice firms.

REPORTING TO CIMA

The following frequently asked questions ("FAQs") were compiled in partnership with CIMA.

The guidance the FAQs provide is intended to assist members of the accounting profession in the Cayman Islands. They are not intended to be prescriptive but rather to indicate what would generally be regarded by the accounting profession in the Cayman Islands as best practice. They should not be relied upon in respect of points of law.

> *1) Question: The relevant laws state that "the auditor shall immediately give the Authority written notice of his information or suspicion". From a timing aspect how is "immediate" defined?*

ANSWER: The auditor should use professional judgment. Internal firm processes and if necessary legal counsel consultation may be required before concluding that a report is required. In certain instances, an auditor may have to perform sufficient audit work or receive further information before he could form a suspicion. For example, he may be presented with a set of management accounts that indicate a going concern situation exists (also see FAQ 5), however at the point of receipt of these statements he is aware that the client has not processed final adjustments. Thus, the auditor may not be able to form an opinion on whether or not to make a report until further information has been provided to him.

2) Question: If the regulated entity or associated service provider has already reported a situation to CIMA does an audit firm also have to report?

ANSWER: Yes, in all such circumstances the audit firms should also report the situation.

3) Question: The relevant laws refer to "carrying on or attempting to carry on business or is winding-up its business voluntarily in a manner that is prejudicial to its investors or creditors". Is there a materiality threshold to apply before making a report to CIMA under this or any other sub-section of the relevant laws?

ANSWER: As a guideline, prior to making any report the auditor should apply a materiality threshold in accordance with their firm's standards and the auditor should utilise a similar thought process as they would when applying materiality to an audit (for example as set out in ISA 320 Audit Materiality/SAS 107, AU312 Audit Risk and Materiality in Conducting an Audit). The auditor should consider both qualitative and quantitative factors for each situation.

4) Question: If an auditor determines that a reportable event exists can they discuss this with their client and/or an associated service provider prior to reporting to CIMA.

ANSWER: In practice this is acceptable. However, each case would have to be assessed individually and there may be instances where it is not appropriate to discuss matters with the client and/or a service provider prior to making a report to CIMA. In the event that a report to the Financial Reporting Authority is required (see FAQ 11 below) care should be taken here to ensure any prior to or after reporting discussions with the client do not contravene the Proceeds of Crime Law by constituting tipping off.

5) Question: The relevant laws refer to "unable or likely to become unable to meet its obligations as they fall due". Has CIMA defined what the insolvency test will be in this context?

ANSWER: No definition has been provided by CIMA, however auditors should consider the appropriate guidance under auditing standards (for example as set out in ISA 570 Going Concern/SAS 59, AU341A The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern). If you conclude your audit report would reflect going concern issues then strong consideration should be given to making a report to CIMA (this may not apply to situations where audit reports refer to going concern matters relating to orderly wind-ups).

6) Question: The relevant laws refer to "carrying on or attempting to carry on business without keeping any or sufficient accounting records to allow its accounts to be properly audited". Has CIMA defined what sufficient accounting records are?

ANSWER: No definition has been provided by CIMA, this is a matter of professional judgment on the part of the auditor. However, a report to CIMA would be required if the auditor has reached a decision to abandon the audit or issue a modified audit opinion solely as a result of insufficient accounting records.

7) Question: Should we be extending our audit procedures to address specific points of the relevant laws beyond that required by generally accepted auditing standards?

ANSWER: No, as stated in the relevant laws *"Nothing in subsection ….shall impose on an auditor carrying out an audit of the accounts …… an obligation to do anything that he would not otherwise be required to do in accordance with generally accepted auditing standards…."*.

8) Question: The relevant laws refer to "carrying on or attempting to carry on business otherwise than in compliance with:

(i) this Law or any regulations made hereunder;

(ii) the Monetary Authority Law;

(iii) the Money Laundering Regulations; or

(iv) a condition of the licence.

Do we report on those matters that are only administrative in nature e.g. annual fees not paid on timely basis, audited financial statement deadline with CIMA not being met, non-communication to CIMA of change to a) Offering Memoranda for funds b) registered office c) name of regulated entity etc.?

ANSWER: CIMA has confirmed that non-filing of audited accounts and non-payment of annual fees will not need to be reported. However, matters such as non-communication of material changes to the Offering Memoranda, a change in the registered or principal office, or a change in the trust company acting as its trustee in accordance with sections 4 (8) and (9) of the Mutual Funds Law should be reported to CIMA.

9) Question: If a limitation on scope qualification under auditing standards (for example in ISA 701 Modifications to the Independent Auditor's Report/SAS 58 (amended SAS79), AU508 Reports on Audited Financial Statements) is likely to be issued is it then reasonable to infer that sufficient accounting records may not be present?

ANSWER: Professional judgment should be used as not all limitation of scope qualifications are as a result of insufficient accounting records. Any report to CIMA should be made when it is concluded that there are insufficient accounting records and this could be prior to the issuance of the related audit opinion.

10) Question: How do those matters reported to CIMA interact with the Proceeds of Crime Law from a tipping off perspective and from possibly doing dual reporting?

ANSWER: Reporting these matters to CIMA would not constitute tipping off under the Proceeds of Crime Law but, care would be needed to ensure that any communication to the client or an associated service provider did not give rise to a tipping off offence (also see FAQ 4). Matters involving knowledge or suspicion of criminal conduct are also required to be reported to the Financial Reporting Authority under the Proceeds of Crime Law.

11) Question: Do all suspicions have to be reported to CIMA regardless of whether they have been dispelled or not.

ANSWER: If suspicions are dispelled there is no need to make a report to CIMA.

12) Question: When performing audit procedures to determine a client's compliance with laws and regulations (for example as set out in ISA 250 Consideration of Laws and Regulations in an Audit of Financial Statements) when would an auditor consider making a report to CIMA?

ANSWER: Professional judgment should be used to determine if a report is to be made, and matters referred to in FAQ 3 on materiality, and FAQ 9 on administrative breaches could be taken into consideration when a decision is required. However, it is generally expected that an auditor would report to CIMA after performing sufficient audit work to conclude that their audit opinion would be modified or disclaimed by the client's non-compliance with laws and regulations.

13) Question: If a modified audit opinion is issued and the auditor considers that sufficient detail is included in the audit report to allow CIMA to extract information from it that would normally be expected to be reported under the relevant laws, is it then necessary to also issue a formal written communication directly to CIMA concerning the reportable matter.

ANSWER: A formal written communication should always be sent to CIMA concerning the reportable matter irrespective of the content of an audit report.

REPORTING TO THE FRA

The FRA is the financial intelligence unit within the Cayman Islands Government that is responsible for receiving, analysing and disseminating disclosures of information concerning criminal conduct, money laundering and the financing of terrorism, pursuant to the provisions of the POCL.

All businesses including professional services firms in Cayman Islands have an obligation under the POCL to report suspicious activity or transactions to the FRA. Reporting to the FRA is made through a Suspicious Activity Report ("SAR"). A SAR should be filed with the FRA as soon as the knowledge or suspicion that criminal proceeds exist has arisen or at the earliest opportunity thereafter.

Audit firms should consider whether any matter identified as being reportable to CIMA under the relevant laws, should also be reported to the FRA as required by POCL. Firms may implement internal procedures to facilitate reporting.

CONSIDERATION OF CONFLICTS WITH ETHICAL AND AUDITING STANDARDS

The IFAC Code of Ethics section 225 which applies to all CIIPA members provides a pathway in the event that an auditor identifies NOCLAR and provides that the auditor must seek to understand and address the NOCLAR and disclose to the relevant Authority depending on the nature and extent of actual or potential harm and gives the following examples of where disclosure should be made:

- Bribery
- Threat to licence
- Listed Client
- Harmful products
- Evading Tax

The auditor may consider its protection and the effectiveness of any disclosure. In general, a disclosure will not amount to a breach of the obligation of confidentiality (section 140).

Auditors are able to discuss any NOCLAR with management or those charged with governance prior to disclosure except where there is an imminent breach of law or regulation that will cause substantial harm to investors, creditors, or the general public in which case the auditor may immediately disclose to the Authority and the risk of committing the Tipping Off offence should be considered.

The reporting requirements to CIMA and the FRA outlined above may also appear to create a conflict with compliance with auditing standards relating to laws and regulations, including International Standard on Auditing 250 *Consideration of Laws and Regulations in an Audit of Financial Statements* ("ISA 250").

ISA 250 also requires the reporting of non-compliance with laws and regulations to appropriate levels of management and those charged with governance. This may conflict with the "tipping off" rules prescribed in the POCL.

Paragraph 20 of ISA 250 states:

*"If the auditor suspects there may be non-compliance, the auditor **shall discuss the matter, unless prohibited by law or regulation, with the appropriate level of management** and, where appropriate, those charged with governance. If management or, as appropriate, those charged with governance do not provide sufficient information that supports*

that the entity is in compliance with laws and regulations and, in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice."

Under the tipping off rules prescribed in the POCL, a person commits an offence if he makes a disclosure which is likely to prejudice any investigation which might be conducted following such disclosure.

Audit firms should consider whether reporting non-compliance with laws and regulations to management or those charged with governance in accordance with ISA 250 may conflict with the tipping off rules, in particular in cases where management or those charged with governance may be involved in any potential investigation. The wording in ISA 250 *"unless prohibited by law or regulation"* allows for compliance with the POCL and other Cayman laws to take precedence over compliance with ISA 250, however firms should consider each case on its merits in accordance with their internal procedures.

In all cases of doubt legal advice may be sought.

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