



How to score an A+ at your next licensee compliance audit

Yvonne was visibly shaking. Sitting opposite me, she peered across the empty board-room table, anticipating my first question with dread. “Relax.” I said – this is just a compliance audit!”

How do you feel the day before the external compliance auditors’ visit? Shaky? Nervous? Oblivious? Unlike Yvonne, if you prepare in advance, you won’t have anything to worry about. We’ve conducted dozens of licensee reviews, and are just busting to tell you the secrets to scoring an A+ at your next one.

Firstly, what is a compliance audit?

I need to deal with this first. Also commonly referred to as a licensee review, a compliance audit occurs when external compliance consultants visit your business and assess it against the requirements of the financial services laws, ASIC policy and best practice. Then they provide you with a report. If the audit is the result of a special licence condition on your licence, or enforceable undertaking, the consultant will also provide that report to ASIC. (A compliance audit shouldn’t be confused with your annual financial audit by ASIC-registered auditors.)

When you got your licence from ASIC, you probably told ASIC that you would have an annual compliance audit. There’s no law that says you have to do it¹, but your undertaking to ASIC during the application process arguably imposes an obligation on the licensee to have it done annually, at least for the first year or two. As time goes on, this may change, as ASIC can’t expect a business to remain the same forever.

¹ That said, there *is* a law that requires licensees to monitor and supervise their representatives.

How to get an A+

So here are our conclusions. If you take heed of what follows, your next compliance audit will be relatively painless. See the diagram for a visual summary. Of course, the list isn’t exhaustive:

1. Allocate resources to compliance

It sounds obvious, but it’s often neglected. Even in a 2-man financial planning practice, there must be someone who puts aside a few hours a week to make sure the licensee is complying with its different obligations. If you don’t put time into compliance, then your compliance audit report will be littered with breaches that will need to be recorded, assessed, and sometimes reported to ASIC.

2. Update your details

Changed address? New authorized representatives? Changed auditors? Make sure you’ve notified ASIC within the specified timeframes. If you were late in telling ASIC, then record the breach on your internal breach register, and assess it for significance.

3. Make sure your written processes reflect what actually happens in practice

Nearly all of you will have a compliance manual. You can probably point to it from where you’re sitting. But do you follow it? Many licensees have not touched this manual since they got it in early 2004. Make sure your compliance manager keeps the manual up to date, so it reflects your current business practices, and the current regulatory environment. If it is a living document, this manual can be like a “compliance paper-trail”, in that it is a good indicator and reflector of the compliance culture in your business. Keep it fresh.

4. Have a risk management system.

The Corporations Act and your licence require you to have a risk management system (unless you're APRA regulated). It should conform to the AS/NZ 4360 standard, and it needs to be updated at least annually. You should view your risk management system as a tool for maintaining long term profitability. It's widely used by businesses outside the financial services sector, too.

5. Train your responsible officers

You should have a written training plan and proof that your responsible officers receive ongoing training. This might be seminars, courses and monthly regulatory updates. If you've got a Key Person condition on your licence, you should also make sure you're training up a successor who can step in if the Key Person leaves the business.

6. Follow a compliance plan

You need a compliance plan that says who's in charge of what. It should be benchmarked against the Australian Standard AS 3806. It should pull together your other compliance procedures, and ideally be short and sweet. It should be easy to read, and targeted at the business – not ASIC. The law says that you need systems to ensure that financial services are provided "efficiently, honestly and fairly". The plan should help you do this.

7. Monitor your outsourced providers

Show how you select and monitor your outsourced providers. They can cause you to breach your licence. For example, it's your fault if your auditors don't submit your financial reports to ASIC within 2, 3 or 4 months of the end of your financial year (this depends on what type of entity the licensee is). You should be monitoring them with KPIs, and have recourse if they cause you to breach your licence. Your outsourcing procedure should show who you outsource to, and how you monitor them.

8. Have a breach reporting procedure

If the licensee has been around for a while, and your breach register doesn't have any breaches in it, then it isn't working. The complexities of FSR dictate that your business will breach its licence at some time, if not often. A breach could be forgetting to provide a Financial Services Guide (FSG). It could be failing to tell ASIC that you changed your registered address within 10 business days. It could be when your receptionist unwittingly provides general advice to a friendly new client. Maybe you forgot to include a soft dollar benefit in your latest Statement of Advice (SOA). Everyone should be trained on what constitutes a breach – this is a nonnegotiable. If a breach is significant, then it should be reported to ASIC using the right form (FS80). Don't be like the example I used above, when the client was petrified that they might have unwittingly breached something. Breaches are normal. In fact, last year ASIC followed up on licensees who hadn't reported any breaches to ASIC. If you keep up to date on the ASIC website, you'll see that the vast majority of ASIC's enforcement action is a result of breaches that they have detected via surveillance or a complaint from someone – not as a result of a breach reported by the licensee.

9. Sign off your promo material

Does your website and advertising include the warnings required by law? This is a common oversight by the licensee. You should have a documented process for signing off promotional material. For example, anything containing general advice to retail clients should be signed off by a PS 146-compliant person. Your procedures should show this.

10. Don't forget about seminars

There are usually general advice warnings and other disclosure obligations that must be followed when you run seminars. Make sure your processes show that you know about them, and that your staff follow them.

11. Comply with cold-calling rules

Your operations should comply with the anti-hawking rules. The *Corporations Act* and ASIC's guide to anti-hawking should be followed when you are cold-calling potential clients, or door-to-door knocking to drum up business.

12. Follow your recruitment and termination procedure

What did you tell ASIC you'd do in the event of appointing a representative? Your employee files should *show* that you've been following this procedure. In a similar fashion you should have a set termination process that's followed. Make sure your employment contracts match up with these procedures.

13. Keep your representative training plans up to date

The *Corporations Act*, your licence and ASIC policy set out the requirements for your representatives. They need to remain competent to provide financial services. If they provide advice to retail clients, they also need annual training plans. Their ongoing training in areas relevant to the financial services they provide should be evident in your documentation.

14. Prove that you are monitoring your representatives

Do you do spot-checks? Do employees use scripts? Keep your monitoring procedures up to date.

15. Have an IT resources procedure

Does your computer crash all the time? Your IT resources procedure should make sure that the business maintains adequate IT resources. You also need a backup procedure and disaster recovery plan. Have you tested them?

16. Show that your resources are monitored and adequate

In addition to your IT resources, you must show that you monitor your human and financial resources. It's up to you to do this properly. A good indicator that you haven't

got adequate human resources is if you're too busy for compliance (although this can also mean you don't prioritise compliance).

17. Keep your dispute resolution procedure current

If you deal with retail clients, have you renewed your membership with your external dispute resolution scheme? We once had a client who forgot to do this, and ASIC telephoned them asking why they didn't report this as a significant breach. We hypothesise that ASIC must cross-reference its database with the bigger EDR membership databases (like the Financial Industry Complaints Service). You also need a set procedure for handling complaints, including designated timeframes and specified reporting lines. If you deal with retail clients, your procedure should be prepared in light of the Australian Standard AS 4269-1995 and ASIC PS 165.

18. Keep your compensation arrangements updated

If you're required to have PI insurance, then make sure you get legal signoff if you renew your policy but change the terms. The law is quite prescriptive for some licensees (eg. Insurance brokers). Have you changed banks? If you have a bond, make sure it's still current.

19. Check your disclosure documents

This area is commonly less than perfect. When was your FSG or SOA template last updated? When did your representatives last receive training on timing issues, and the difference between general advice, personal advice and no advice? Do your files show that the disclosure documents were provided at the right time? Do your procedures show who received an FSG, which version and when? These are requirements of the law and ASIC policy.

20. Update your research list

If you service retail clients, and research your products, then you need to have a procedure that sets out why you've chosen the products you have. ASIC says that

adopting someone else's rating system, per se, is not good enough. Make sure your procedure is followed, and it explains what a representative must do if he or she wants to recommend a product not on the list.

21. Use your conflicts of interest register

When the requirement to have a conflicts of interest procedure and register came in (2005), most people scratched something together and put it in their compliance manual. But, does it actually contain identified conflicts? Does it manage conflicts? If you're stumped for any conflicts, ASIC released a discussion paper in April 2006, which is packed full of examples. As you can see, preparing for a compliance audit is not a walk in the park. But, if you have a positive culture of compliance, it won't be a problem. In order to keep a handle on all these components, try using a good compliance diary. We provide them to clients, and have found them to be quite successful. Finally, you should think of compliance audits as a tool for positive change and a roadmap for navigating through the numerous regulatory obligations faced by licensees. You don't know what you don't know. Accordingly, any breaches, findings and recommendations in the report will ultimately make your business a better business, if you act on them.

The law is current as at April 2007. Please note that this paper is a summary of the law only and is not a substitute for legal advice. Holley Nethercote is able to assist companies in meeting their obligations in this area by providing practical and prompt legal advice.

Training and creation of compliance programs are also available via an associated business, Compact-Compliance and Corporate Training.

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