

# **DFSA'S AUDIT MONITORING PROGRAMME**

**Public Report 2013**

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## I. Foreword

I am very pleased to present the second public report (Report) on the Dubai Financial Services Authority (DFSA)'s audit monitoring programme.

This Report covers audit inspections conducted by the DFSA in the period 1 January 2013 to 31 December 2013 (Period).

2013 saw a number of significant milestones in respect of our work on audit.

Our first audit monitoring report was issued in April 2013 covering five years of audit inspections conducted by the DFSA from 2008 to 2012. This report was well received by stakeholders.

In 2013, the European Commission (Commission) announced its decision to grant the DFSA's audit monitoring system 'equivalent status' with European Union (EU) Member States. Following a rigorous assessment of the supervisory regime for auditors in the Dubai International Financial Centre (DIFC), the Commission considered the DFSA's audit oversight system equivalent with that of EU Member States.

The DFSA completed its assessment of Registered Auditors (RAs) of Public Listed Companies (PLCs) in 2013. This was the first assessment since the DFSA expanded its audit monitoring scope to RAs of PLCs.

On the international front, the DFSA contributed by delivering sessions at the International Forum of Independent Audit Regulators<sup>1</sup> (IFIAR) 7th Inspection Workshop. IFIAR Inspection Workshops are organised annually to train the audit inspection staff of IFIAR members.

The DFSA completed its review of the regulations in respect of audit. With over five years of active operational experience with the auditor regime, the review provided an opportunity to address common issues arising from audit inspections and supervision. The consultation period closed on 14 February 2014. We have received an encouraging response to the proposed auditor regime.

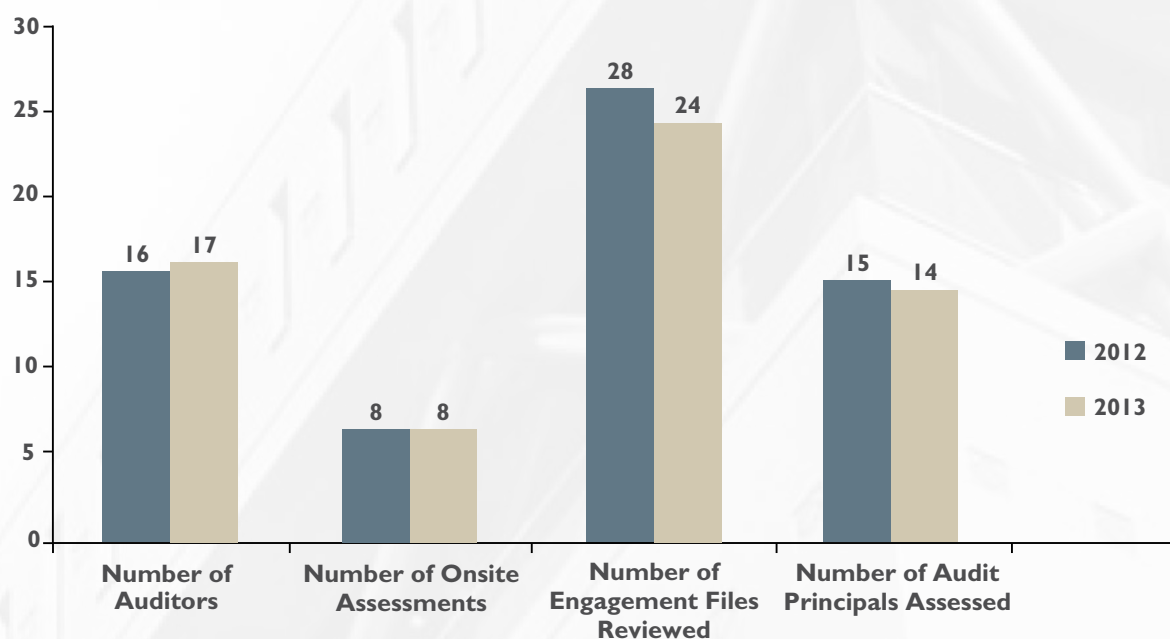
The DFSA, in association with The Institute of Chartered Accountants in England and Wales (ICAEW) Middle East, hosted a breakfast briefing entitled "The Challenges of Emiratisation: attracting talent into the finance industry", which was attended by approximately 100 representatives of the accountancy and finance industry from across the region.

The purpose of our audit monitoring programme is to assess whether RAs in the DIFC meet international standards. The DFSA Rulebook sets out these standards which include: the International Standards on Auditing (ISAs), the International Standard on Quality Control (ISQC 1) and the Code of Ethics for Professional Accountants (Code of Ethics) issued by International Federation of Accountants (IFAC).

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<sup>1</sup> IFIAR is an organisation of independent audit regulators. The organisation's primary aim is to enable its members to share information regarding the audit market environment and practical experiences of independent audit regulatory activity, with a focus on inspections of audit firms. Currently, there are 46 members including the DFSA.

During the period covered by this Report, seventeen (17) RAs were registered<sup>2</sup> with the DFSA. The DFSA conducted eight (8) audit inspections, assessed fourteen (14) Audit Principals and reviewed twenty four<sup>3</sup> (24) audit engagement files focusing on the substance of a RAs work and assessing whether sufficient and appropriate evidence was obtained and documented to support the conclusions reached in relation to key audit judgements.



*Chart 1: A summary of results of audit monitoring for the Period.*

In 2013, the DFSA announced that its audit monitoring focus for the year would be on audit evidence, professional scepticism, involvement of Audit Principals and independence.

I am pleased that we observed improvements in these areas compared to 2012. The overwhelming majority of Audit Principals were involved in audits from start to finish, taking carriage and control of these audits. We observed that the Audit Principals acted with greater professional scepticism and RAs made a deliberate effort to remain independent. However, we did identify some instances where employees of RAs assisted with the preparation of financial statements. In addition, and in some cases they held an Authorised Individual status, and in so doing, assumed management responsibility while simultaneously continuing to audit financial statements.

The DFSA communicates its findings with RAs on an individual basis and also through our annual outreach sessions which detail aggregate findings from the previous year's inspections as well as areas of interest for the coming year's inspection programme.

<sup>2</sup> A full list of RAs registered with the DFSA can be obtained from DFSA's Public Register (<http://www.dfsa.ae/PublicRegister/Default.aspx>).

<sup>3</sup> The ICAEW assisted the DFSA in reviewing six (6) audit engagement files.

With respect to all of the key findings of this Report, the DFSA has taken a wide range of actions, from written observations to specific requirements for RAs to implement recommended actions and in some cases placing Audit Principals on close supervision.

For 2014, the DFSA will continue to inspect RAs of Authorised Firms (AFs), Authorised Market Institutions (AMIs) and PLCs. Areas of future focus for RAs include:

- 1) Planning an audit of financial statements; and
- 2) Materiality in planning and performing an audit.

I am confident that you will find that reading this Report will assist your understanding of the DFSA's role and expectations regarding RAs in the DIFC.



**Ian Johnston**  
Chief Executive

## 2. About this Report

This Report summarises the results of the DFSA's monitoring visits of RAs of AFs, AMIs and PLCs conducted over a period of twelve (12) months and sets out key issues identified during 2013.

This Report complies with the IFIAR Core Principles<sup>4</sup> for Independent Audit Regulators, in particular, Principle 3 relating to the transparency and accountability of audit regulators.

In the course of the review of a sample of selected audit engagement files of an RA, an audit monitoring visit may identify ways in which a particular audit engagement file is deficient. It is not the purpose of an audit monitoring visit, however, to review all of the RAs audit engagements or to identify every deficiency which may exist in an audit engagement. Accordingly, this Report does not provide any assurance that the RAs audits of the financial statements are free of deficiencies not specifically described in this Report.

Unless stated otherwise, not all matters in this Report apply to every RA.

During this Period, the DFSA also carried out inspections focused on RAs Anti-Money Laundering (AML) obligations. The findings of those inspections are not included in this Report.

This Report does not cover any enforcement actions taken by the DFSA on RAs. All outcomes of enforcement actions are reported on the DFSA's website ([www.dfsa.ae](http://www.dfsa.ae)) and through separate media releases.

Reference to "instances", "occasions", "audit engagement files" and "engagement teams" in the findings should be considered in relation to a finding on a particular audit while reference to "RA" should be considered in relation to whole firm-wide related issues.

In Section 5, certain comparative information has been reclassified to conform to the current year's presentation.

We hope this Report is beneficial to RAs, other audit firms, AFs, AMIs, PLCs, audit committees and other interested stakeholders.

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<sup>4</sup> The Core Principles seek to promote effective independent audit oversight globally, thereby, contributing to members' overriding objective of serving the public interest and enhancing investor protection by improving audit quality.

### 3. Dubai Financial Services Authority

The DFSA is the independent regulator of financial and designation non-financial business and professional services conducted in or from the DIFC, a purpose-built financial free-zone in Dubai.

The DFSA regulates a broad range of Firms based in the DIFC, including banks, insurers, fund managers, advisory firms and brokers, exchanges and clearing houses, together with credit rating agencies, RAs and designated non-financial business and professionals (DNFBPs). These firms provide a wide range of services to their clients, including Islamic finance.

In addition to regulating financial and DNFBP services, the DFSA is responsible for supervising and enforcing AML and counter-terrorist financing requirements applicable in the DIFC. The DFSA has also accepted a delegation of powers from the DIFC Registrar of Companies to investigate the affairs of DIFC companies and partnerships where a material breach of DIFC Companies Law is suspected and to pursue enforcement remedies that are available to the Registrar.

With respect to RAs, the DFSA is responsible for the registration, oversight and suspension / removal of RAs in the DIFC in respect of AFs, AMIs and PLCs.

## 4. Key findings

Overall, the DFSA observed improvements compared to 2012. Reviews of engagement files across RAs inspected raised a small number of issues about the sufficiency and appropriateness of evidence obtained by RAs to support their conclusions on significant areas of the audit. Key findings were mainly in the areas outlined below:

### 4.1 Audit evidence and professional scepticism

Our audit monitoring visits focused on whether the Audit Principals obtained sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base their opinion.

The DFSA observed improvements in these areas compared to 2012. The majority of Audit Principals acted with greater professional scepticism and obtained quality audit evidence. Although we identified minor documentation issues, there was sufficient audit evidence obtained on the majority of the audit engagement files.

Where appropriate, we challenged Audit Principals on whether the evidence obtained and documented on audit engagement files for specific audit assertions was sufficient, appropriate and supported the significant judgements made to reach their conclusions and form their opinions.

#### Findings from particular files

- An engagement team failed to identify client money which was deposited into an AFs own bank account. The cash was received from an investor before the end of the year and was held in the AFs own bank account at the year-end without appropriate segregation. The AFs licence does not allow it to hold client money or make investments on behalf of investors.

The engagement team also failed to consider its obligations to report this matter to the DFSA, nor the implications for the audit report to the AF.

- Unsatisfactory audit work had been done on a material cash balance. The engagement team failed to perform sufficient audit procedures to verify the existence and valuation of this amount. The engagement team only relied upon internal confirmation from the management for this cash amount.
- An engagement team failed to control the external confirmation process. Confirmations received directly from independent third parties are good quality evidence. The RA acknowledged that its internal procedure needs to be amended to ensure that the RA controls the process for sending the bank confirmations.



## 4.2 Involvement of Audit Principal

In accordance with DFSA's rules, an RA should appoint an Audit Principal who is responsible for the direction, supervision and performance of the audit engagement.

The Audit Principal should take responsibility for the overall quality on each audit engagement to which that Audit Principal is assigned in accordance with ISA 220 – "Quality control for an audit of financial statements."

We reviewed audit engagement files for evidence of sufficient and appropriate involvement of Audit Principals. An overwhelming majority of Audit Principals were involved in audits from start to finish taking carriage and control of these audits. We identified the following isolated incidents.

### Findings from particular files

- The Audit Principal, who retained responsibility for signing the audit report, was not sufficiently involved in the audit. The Audit Principal did not reach a timely conclusion on client retention and independence related matters. There was also no evidence of timely approval of the audit plan. Timely reviews by the Audit Principal at appropriate stages during the audit allow significant matters to be resolved on a timely basis.

The Audit Principal also did not attend the team planning meeting. ISA 315 – "Identifying and assessing the risks of material misstatement through understanding the entity and its environment" requires a discussion among the engagement team members including the Audit Principal. This discussion places particular emphasis on how and where the entity's financial statements may be susceptible to material misstatements due to fraud.

- The RA was subject to an External Quality Control Review (EQCR) requirement by the DFSA. The DFSA reviewed the EQCR reports for the same engagement files which were inspected by the DFSA. The EQCR reports failed to identify issues raised by the DFSA during the inspection of these audit files.

The purpose of the EQCR was to provide an objective evaluation, on or before the date of the report, of the significant judgements the engagement team made and the conclusions it reached in formulating the report. The DFSA concluded that the EQCR failed to discharge its duties effectively.

## 4.3 Independence

Independence is defined under the IFAC Code as Independence of mind<sup>5</sup> and appearance<sup>6</sup>.

We reviewed compliance with the IFAC Code with a focus on independence and conflicts requirements in the context of non-assurance services provided to assurance clients. We observed that RAs are generally familiar with the requirements of the IFAC Code and made a deliberate effort to remain independent. RAs also had a robust training programme so their staff remained up-to-date with the independence requirements.

We identified a very small number of audit engagement files where employees of RAs assisted with the preparation of financial statements. In addition and in some cases, they held an Authorised Individual status, and in so doing, assumed management responsibility while simultaneously continuing to audit the financial statements.

### Findings from particular files

- The engagement team provided assistance with preparation of financial statements for two (2) of its audit clients. As per the IFAC Code, preparation of financial statements for an audit client creates a self-review threat when the engagement team subsequently audits these financial statements.

The RA may provide services related to the preparation of financial statements based on information in the trial balance to an audit client which is not a public interest entity so long as any self-review threat created is reduced to an acceptable level. In any case, the significance of any such threat created should be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards include arranging for such services to be performed by an individual who is not a member of the audit team.

Based on the discussion with the person in-charge on both audits, members of the engagement team who assisted in preparation of these financial statements subsequently performed the audit. Although the engagement team correctly identified the self-review threat, they failed to document the evaluation by which the self-review threat was mitigated to an acceptable level.

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<sup>5</sup> Independence of mind: the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgement, thereby, allowing an individual to act with integrity and exercise objectivity and professional scepticism.

<sup>6</sup> Independence of appearance: the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would likely to conclude, weighing all the specific facts and circumstances, that a firm's, or a member of the audit or assurance team's, integrity, objectivity or professional scepticism has been compromised.

- The RA was appointed as independent auditor of two (2) AFs where an employee of the RA acted as the outsourced Compliance Officer (CO) of the AF. In accordance with the DFSA Rules, a CO is a licensed function which is carried out by an individual who is a Director, Partner or Senior Manager of an AF. The audit file did not sufficiently and appropriately document the RAs conclusion with independence requirements and the substance of any relevant discussions that supported that conclusion.

## 5. Other findings

The DFSA has classified other findings into the following categories:



Chart 2: Number of engagement files that had these findings.

These findings were communicated to respective RAs in a detailed form.

A full summary of all findings is provided in Appendix I. Although the DFSA identified minor documentation issues in 83% of the audit engagement files inspected, the nature of these issues was not significant.

### Key issues

#### Audit planning

- 29% of the audit engagement files inspected did not consider an auditor's right and duty to report to the DFSA under Article 104(3) of DIFC Law No. 1 of 2004; and
- 13% of the audit engagement files inspected failed to show sufficient evidence that the procedures required to address the risk of fraud had been conducted, as stated in ISA 240 – "The auditor's responsibilities relating to fraud in an audit of financial statements."

#### Audit conclusion

- 17% of the audit engagement files inspected failed to evidence communication to those charged with governance.

## Appendix I – Other findings

Below is a full summary of the key findings reported in Section 5 of this Report

Description of other findings	Number of engagement files that had these findings		Number of RAs that had these findings	
	2013	2012	2013	2012
<b>Independence</b>				
Assistance in preparation of financial statements for audit clients (self-review threat)	2	2	1	1
Failure to obtain timely professional clearance in writing from the predecessor auditor	1	Nil	1	Nil
<b>Audit planning</b>				
No consideration for the auditor's right and duty to report to regulators under Article 104(3) of DIFC Law No. 1 of 2004	7	7	3	3
Failure to show sufficient evidence that the procedures required to address the risk of fraud had been conducted, as stated in ISA 240 – "The auditor's responsibilities relating to fraud in an audit of financial statements"	3	4	2	2
Failure to document an understanding of internal controls of the entity relevant to the audit in accordance with ISA 315 – "Identifying and assessing the risks of material misstatement through understanding the entity and its environment"	2	2	1	1
Insufficient documentation of audit planning in order to comply with the requirements of ISA 315 – "Identifying and assessing the risks of material misstatement through understanding the entity and its environment"	2	2	1	1
No evidence to substantiate appropriate analytical procedures as required by ISA 520 – "Analytical procedures"	2	2	1	1
Materiality	1	1	1	1
Failure to document the matters discussed at the team planning meeting	Nil	6	Nil	2
<b>Audit execution</b>				
The audit engagement files had minor documentation issues	20	10	8	8
Failure to keep proper control over the external confirmation process as required by ISA 505 – "External confirmations"	3	10	1	5
Failure to demonstrate cut-off testing to ensure cash transactions were initiated in the same period	2	Nil	2	Nil
Audit evidence on revenue appeared to be insufficient and the quality of audit documentation was poor	Nil	5	Nil	3

Description of other findings	Number of engagement files that had these findings		Number of RAs that had these findings	
	2013	2012	2013	2012
No standard procedure for selection of sample size	Nil	2	Nil	1
Failure to document rationale for conclusion	Nil	1	Nil	1
<b>Audit conclusion</b>				
Failure to evidence communication to those charged with governance in accordance with ISA 260 – “Communication with those charged with governance” and ISA 265 – “Communicating deficiencies in internal control to those charged with governance”	4	Nil	3	Nil
Insufficient documentation of work done on subsequent events	2	Nil	1	Nil
Insufficient documentation of work carried out on material journal entries	2	Nil	1	Nil
The contents of the representation letter did not comply with the requirements of ISA 580 – “Written representation”	Nil	3	Nil	1
Failure to evaluate and document the aggregated uncorrected misstatements arising out of the audits	Nil	2	Nil	1
<b>Audit review procedures</b>				
EQCR	3	Nil	2	Nil
Audit Principal not involved throughout the audit	3	Nil	2	Nil
<b>Financial statements disclosures and audit report</b>				
Minor disclosure issues where the financial statements disclosures were not in accordance with IFRS	4	5	2	3
References in the audit report to non-applicable laws	Nil	5	Nil	2
Audit opinion did not comply with the requirements of the DFSA Rulebook	Nil	1	Nil	1
<b>Whole firm-wide</b>				
Absence of a formal and documented process for partner/staff appraisal and evaluation	N/A	N/A	1	5
Failure to follow an appropriate mechanism to ascertain the limits for professional indemnity insurance	N/A	N/A	Nil	4
Failure to maintain adequate training records	N/A	N/A	Nil	1



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