

# DFSA'S AUDIT MONITORING PROGRAMME

**Public Report 2014**

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## I. Foreword

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

### **Purpose of DFSA's audit monitoring programme**

The role and duty of a Registered Auditor (RA) is intended to enhance investor confidence, ensuring the financial statements in the Dubai International Financial Centre (DIFC) comply with the required financial reporting standards and give a true and fair view of the financial position of the entity being audited. The purpose of our audit monitoring programme is to assess whether RAs in the DIFC conduct audits in accordance with the International Standards on Auditing (ISAs), the International Standard on Quality Control (ISQCI) and the Code of Ethics for Professional Accountants (Code of Ethics) issued by the International Federation of Accountants (IFAC).

This Report covers audit inspections conducted by the DFSA in the period 1 January 2014 to 31 December 2014 (Period).

### **2014 Roundup**

The DFSA has achieved a great deal in 2014 in the area of audit monitoring. I am pleased to share the following:

- Our second audit monitoring report was issued in April 2014 covering audit inspections conducted by the DFSA in 2013. This report also presented a comparison with the results of 2012 which was well received by the stakeholders.
- In August 2014 a dedicated Auditor (AUD) Module was introduced combining all relevant requirements for RAs of DFSA Authorised Firms (AFs), Domestic Funds (DFs), Authorised Market Institutions (AMIs) and Public Listed Companies (PLCs).
- The DFSA hosted its fifth Annual Audit Outreach for its RAs. Over 75 Audit Principals, Money Laundering Reporting Officers and key audit staff participated. The DFSA presented key findings of audit inspections conducted by the DFSA in 2013.
- The DFSA conducted its first workshop for Audit Principals. This workshop focused on the key regulatory changes resulting from the enhanced Auditor Regime.
- The DFSA contributed to international developments by delivering sessions at the International Forum of Independent Audit Regulators<sup>1</sup> (IFIAR) 8<sup>th</sup> Inspection Workshop. IFIAR Inspection Workshops are organised annually to train the audit inspection staff of IFIAR members.

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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 51 members including the DFSA.

- Staff of the DFSA presented on the topic of “the Profession’s Role in Improving Public Oversight” at the second Accountancy Development for Results (ADR) global event hosted by the World Bank and the IFAC. The ADR event attracted 120 participants from around the world.
- The DFSA also presented at the 2014 Public Company Accounting Oversight Board (PCAOB) International Auditor Regulatory Institute on the topic of “Issues Facing Regulators from Emerging Markets”. The event was attended by a number of participants from 30 jurisdictions.
- Finally, the DFSA has been authorised as an “ACA Training Employer” by the Institute of Chartered Accountants in England and Wales (ICAEW). ACA is ICAEW’s Chartered Accountant qualification and will provide to our Tomorrow’s Regulatory Leaders (TRL) graduates and other employees a combination of technical knowledge, professional skills and practical experience.

### Reflection on 10 year progress

The DFSA and DIFC each celebrated its 10<sup>th</sup> anniversary in 2014. I take this opportunity to reflect upon the progress of our Auditor Regime since its inception. The timeline below shows our persistent efforts in building our Auditor Regime over the last decade.

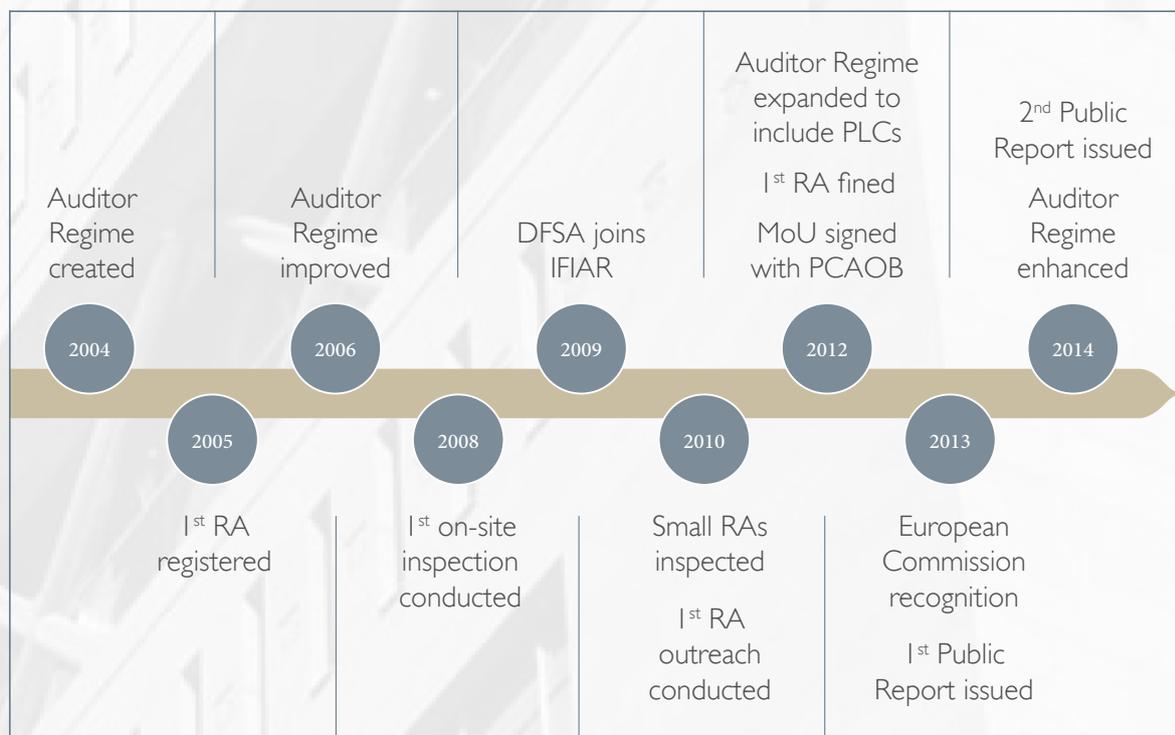
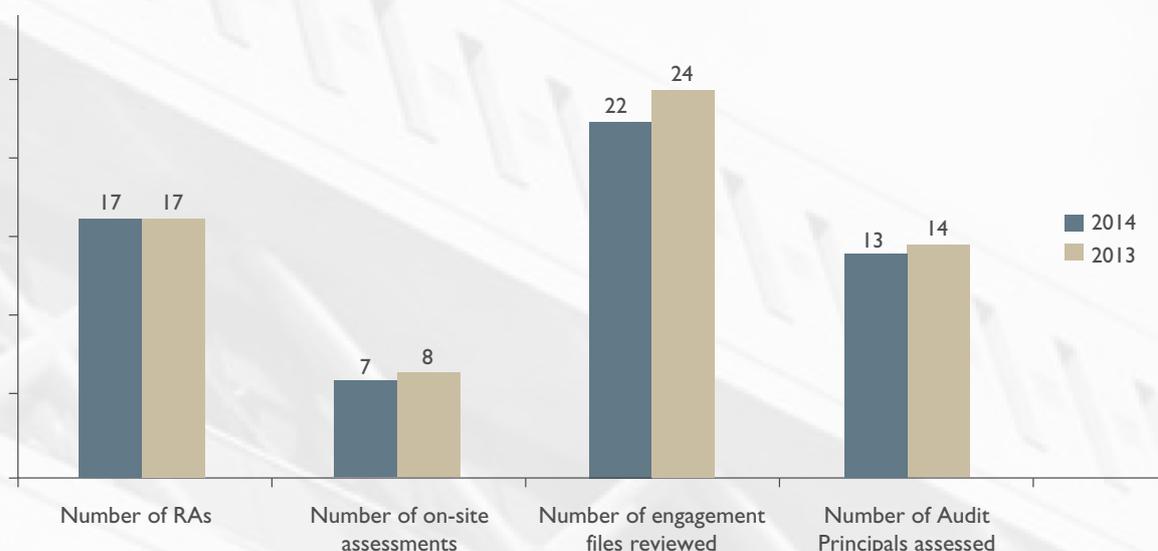


Chart 1: DFSA’s Auditor Regime over the past 10 years.

## Audit monitoring statistics

During the Period covered by this Report, the DFSA registered two RAs whereas the registration of two RAs was withdrawn, bringing the total number of RAs to seventeen<sup>2</sup>.

Out of these seventeen RAs the DFSA conducted seven audit inspections, assessed thirteen Audit Principals and reviewed twenty two<sup>3</sup> audit engagement files, focusing on the substance of the 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 2: Summarised results of audit monitoring for the Period.*

In 2014, we announced our audit monitoring focus for the year would be on:

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

We also continued with the audit monitoring focus announced for 2013 i.e. audit evidence, professional scepticism, involvement of Audit Principals and independence.

We inspected the RAs with the above mentioned audit monitoring focus. I am pleased to say that majority of the RAs were able to maintain quality in the audits we reviewed. RAs also expressed that these audit inspections have a positive impact on the overall audit quality at a whole-firm level. The DFSA observed that there was appropriate support from senior leadership regarding audit quality measures which directly impacted the audit quality.

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

<sup>3</sup> The ICAEW assisted the DFSA in reviewing eleven audit engagement files.

The DFSA communicates its findings with RAs on an individual basis and also through its 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.

With respect to the key findings of this Report, the DFSA has taken a range of actions, from written observations, to specific requirements for RAs to implement actions and to placing Audit Principals under close supervision.

For 2015, the DFSA will continue to inspect RAs of AFs, DFs, AMIs and PLCs. Areas of future focus for RAs will include:

- 1) Communication with those charged with governance; and
- 2) Communicating deficiencies in internal control to those charged with governance and management.

I am confident that you will find this Report beneficial.



**Ian Johnston**  
Chief Executive

## 2. About this Report

This Report summarises the results of the DFSA's monitoring visits of RAs of AFs, DFs, AMLs and PLCs conducted over a period of twelve months and sets out key issues identified during 2014.

This Report complies with the IFIAR's 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 and RAs' compliance with GEN and AUD Rules for the purposes of regulatory returns and other regulatory reports. 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, DFs, AMLs, 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 services conducted in or from the DIFC, a purpose-built financial free-zone in Dubai, United Arab Emirates.

The DFSA's regulatory mandate includes asset management, banking and credit services, securities, collective investment funds, custody and trust services, commodities futures trading, Islamic finance, insurance, an international equities exchange and an international commodities derivatives exchange together with credit rating agencies, RAs and designated non-financial businesses and professions (DNFBPs).

In addition to regulating financial and ancillary services, the DFSA is responsible for supervising and enforcing AML and Counter Terrorist Financing (CTF) requirements applicable in the DIFC. The DFSA has also accepted a delegation of powers from the DIFC Registrar of Companies (Registrar) 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 and Audit Principals in the DIFC in respect of their audit of AFs, DFs, AMIs and PLCs.

## 4. Key focus areas

Overall, the DFSA observed improvements compared to 2013. Reviews of engagement files across the 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.

The DFSA continued to conduct follow-up inspections of RAs of AFs, DFs, AMIs and PLCs. Where significant issues were identified in previous inspections, we escalated follow-up inspections to ensure the RAs were taking prompt and appropriate action to address our observations and findings.

For the RAs not inspected in 2013, the DFSA continued with the key focus areas announced for 2013 namely, audit evidence and professional scepticism; involvement of Audit Principals; and independence.

Key findings for the above mainly in the areas are 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 2013. 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**

- Two RAs failed to control the external confirmation process. Confirmations received directly from independent third parties are good quality evidence. The RAs acknowledged that their internal procedures need to be amended to ensure that the RAs control the process for sending bank confirmations.
- An engagement team chose to use a “negative confirmation” method to verify the existence and valuation of significant debtor and creditor balances.

Negative confirmations provide less persuasive audit evidence than positive confirmations. In accordance with ISA 505 – External Confirmations, an auditor should not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level. Also, the working papers did not clearly reflect the extent of verification performed on the significant debtor and creditor balance by way of alternative procedures.

## 4.2 Involvement of Audit Principal

Under DFSA rules, an Audit Principal is responsible for the direction, supervision and performance of the audit engagement.

In accordance with ISA 220 – Quality Control for an Audit of Financial Statements, the Audit Principal should take responsibility for the overall quality on each audit engagement to which that Audit Principal is assigned.

We continued to review audit engagement files for evidence of sufficient and appropriate involvement of Audit Principals. As compared to 2013, we have seen that 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:

### Findings from the particular files

- On two engagement files, the signing Audit Principals relied on an inter-office opinion signed by another Audit Principal and did not manage the conduct of the audit as required by the DFSA Rules. The other Audit Principal who managed the conduct of both the audits, failed to maintain his continued membership of a Recognised Professional Body which, under the DFSA Rules, is a key fitness and propriety criteria for an Audit Principal. The RA acknowledged DFSA's observation and immediately removed the other Audit Principal on audits of the DFSA regulated entities.

## 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.

After DFSA selected this area as a focus for 2013 and had discussions at the annual RA outreach, we observed that RAs made a significant improvement as compared to 2013. RAs and their employees, including Audit Principals, were aware of the requirements of the IFAC Code and made a conscious effort to remain independent. Most RAs also had an impressive training programme keeping their staff up-to-date with the independence requirements.

### Findings from the particular files

- On two engagement files, the Audit Principals failed to sign the annual independence confirmations as required by the IFAC Code.

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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 in 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.

For 2014, the DFSA announced two key areas of focus which were planning an audit of financial statements and materiality in planning and performing an audit.

## 4.4 Planning an audit of financial statements

Planning an audit involves establishing the overall audit strategy and developing an audit plan. Adequate planning benefits the audit of financial statements by devoting appropriate attention to important areas of the audit and identification and resolution of potential problems on a timely basis.

Our audit monitoring visits continued to focus on whether the Audit Principals established an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

Where appropriate, we challenged Audit Principals on whether the overall audit strategy and audit plan was appropriate.

We did not identify significant issues related to this theme.

## 4.5 Materiality in planning and performing an audit

When establishing the overall audit strategy, the Audit Principal determines materiality for the financial statements as a whole. This materiality is revised for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) in the event of becoming aware of information during the audit that would have caused the Audit Principal to have determined a different amount initially.

Our audit monitoring visits continued to focus on whether Audit Principals established appropriate levels of materiality for the audit of financial statements. Determining materiality involves the exercise of professional judgement therefore, where appropriate, we challenged Audit Principals on whether the established materiality levels were appropriate.

We did not identify significant issues related to this theme.

## 5. Other findings

The DFSA has classified other findings into the following categories:

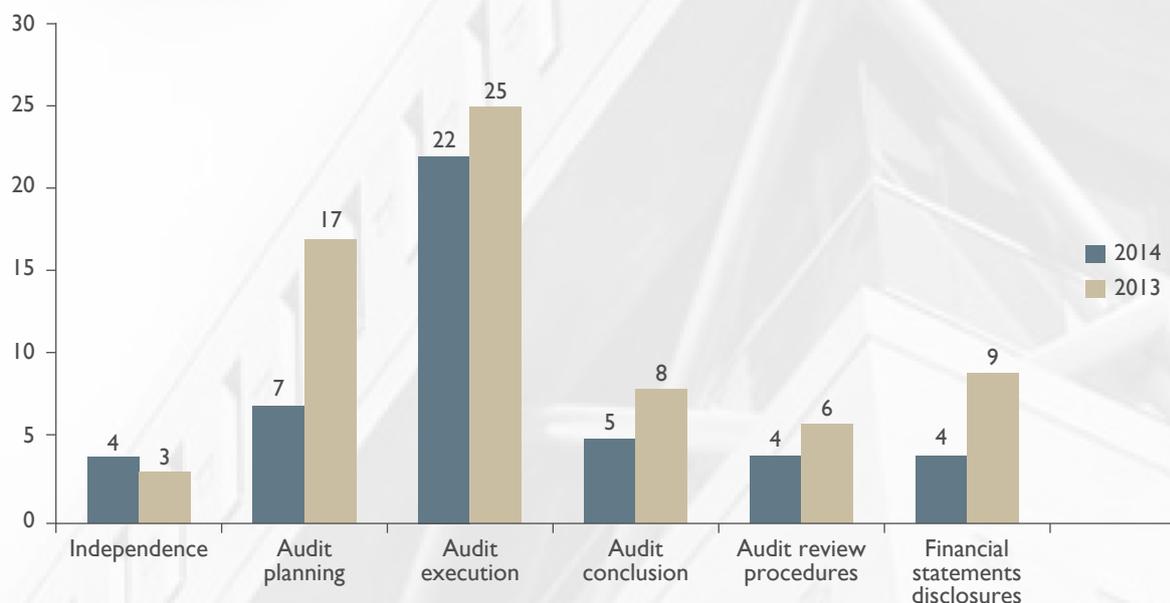


Chart 3: Number of engagement files that had these findings.

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

Below is a summary of the other findings. A full summary of all findings is provided in Appendix I. Although the DFSA identified minor documentation issues in 77% (2013: 83%) of the audit engagement files inspected, we did not consider this as significant given the nature of the underlying issues.

### Key issues

#### Independence

- 18% of the audit engagement teams under inspection failed to obtain independence confirmation from staff including Audit Principals.

#### Audit planning

- 18% of the audit engagement files inspected failed to reflect procedures performed to understand controls; and
- Engagement letters in 9% of the audit engagement files did not contain the expected form and contents of the audit report as required by ISA 210 – Agreeing the Terms of Audit Engagements.

#### Audit conclusion

- Work on journal entries and subsequent events required improvement in 9% of the audit engagement files inspected.

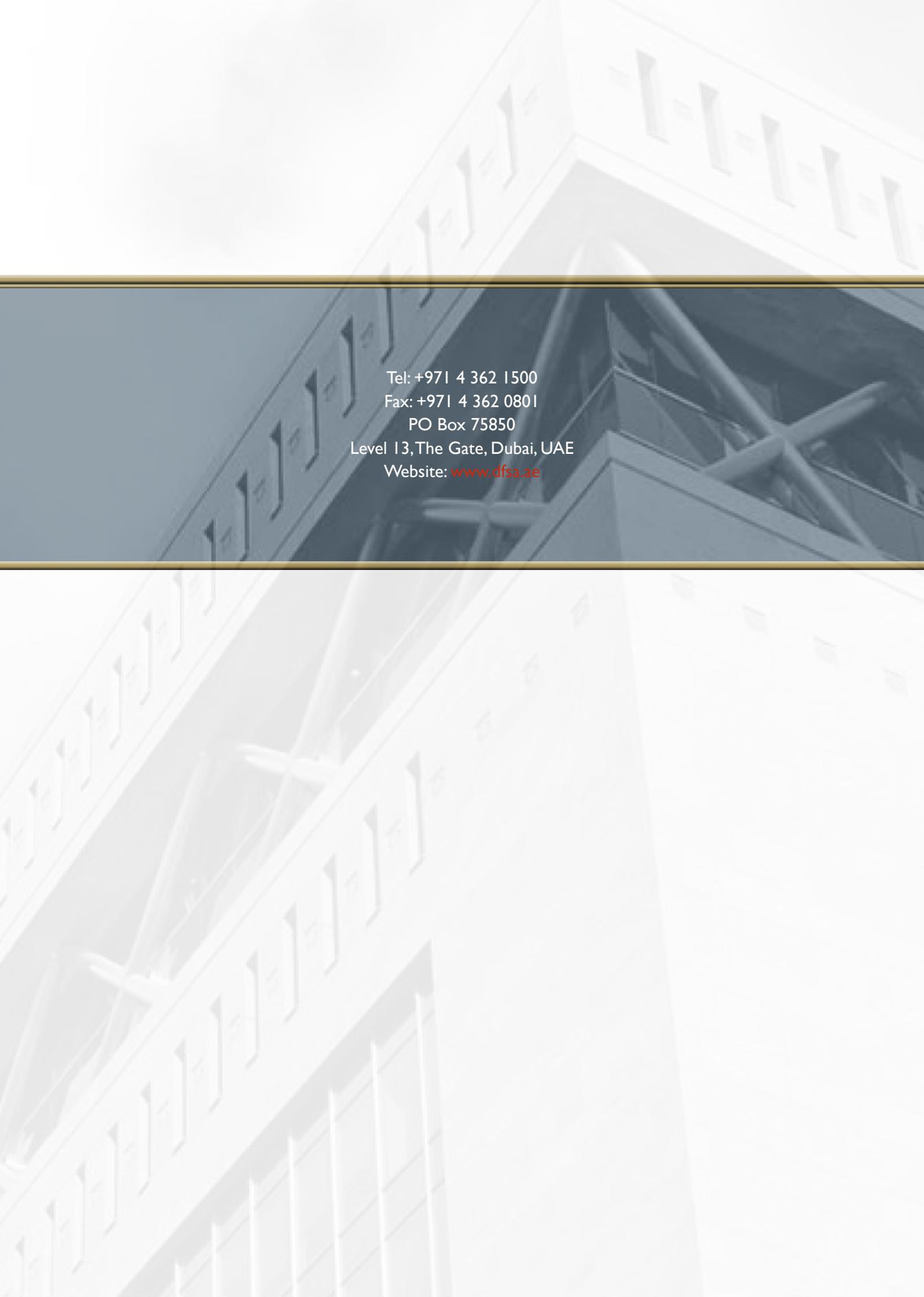
## Appendix I – Other findings

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	
	2014	2013	2014	2013
<b>Independence</b>				
Failure to obtain independence confirmation from staff including Audit Principals	4	Nil	2	Nil
Assistance in preparation of financial statements for audit clients (self-review threat)	Nil	2	Nil	1
Failure to obtain timely professional clearance in writing from the predecessor auditor	Nil	1	Nil	1
<b>Audit planning</b>				
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	4	2	2	1
Engagement letter did not contain the expected form and contents of the audit report as required by ISA 210 – Agreeing the terms of audit engagements	2	Nil	1	Nil
Failure to consider implication of DIFC Data Protection Law	1	Nil	1	Nil
No consideration for the auditor's right and duty to report to regulators under Article 104(3) of DIFC Law No. 1 of 2004	Nil	7	Nil	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	Nil	3	Nil	2
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	Nil	2	Nil	1
No evidence to substantiate appropriate analytical procedures as required by ISA 520 – Analytical procedures	Nil	2	Nil	1
Materiality	Nil	1	Nil	1
<b>Audit execution</b>				
The audit engagement files had minor documentation issues	17	20	4	8
Failure to keep proper control over the external confirmation process as required by ISA 505 – External confirmations	4	3	2	1

Description of other findings	Number of engagement files that had these findings		Number of RAs that had these findings	
	2014	2013	2014	2013
Failure to demonstrate cut-off testing to ensure cash transactions were initiated in the same period	Nil	2	Nil	2
Insufficient work on assessment of going concern	1	Nil	1	Nil
<b>Audit conclusion</b>				
Insufficient documentation of work done on subsequent events	2	2	1	1
Insufficient documentation of work carried out on material journal entries	2	2	1	1
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	1	4	1	3
<b>Audit review procedures</b>				
Audit Principal not involved throughout the audit	4	3	2	2
Issues with the quality of Engagement Quality Control Review	Nil	3	Nil	2
<b>Financial statements disclosures and audit report</b>				
Minor disclosure issues where the financial statements disclosures were not in accordance with IFRS	4	9	3	4
<b>Whole firm-wide</b>				
Failure to maintain adequate training records			2	Nil
Absence of a formal and documented process for partner/staff appraisal and evaluation			1	1
Failure to follow an appropriate mechanism to ascertain the limits for professional indemnity insurance			1	Nil
Failure to implement an internal monitoring of engagement files			1	Nil





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