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Consultation Paper 91
Policy & Legal Services
DFSA
PO Box 75850
Dubai
UAE

Dear Sirs

DUBAI FSA PROPOSED ENHANCEMENTS TO AUDITOR REGIME

ICAEW is pleased to respond to your request for comments on the Audit Consultation paper 91 "Proposed Enhancements to the Auditor Regime".

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

DUBAI FSA PROPOSED ENHANCEMENTS TO AUDITOR REGIME

Memorandum of comment submitted in February 2014 by ICAEW, in response to the Dubai Financial Services Authority Consultation Paper no 91 Proposed Amendments to the Audit Regime published in December 2013

Contents	Paragraph
Introduction	1
Who we are	2 - 7
Major points	8 - 10
Responses to specific questions	11 - 51

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper No 91 *Proposed Enhancements to the Auditor Regime* published by the Dubai Financial Services Authority (DFSA) on 16 December 2013, a copy of which is available from this [link](#).

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 142,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
4. The Audit and Assurance Faculty is a leading authority on external audit and other assurance activities and is recognised internationally as a source of expertise on audit issues. It is responsible for technical audit and assurance submissions on behalf of ICAEW as a whole. The faculty membership consists of nearly 8,000 members drawn from practising firms and organisations of all sizes from both the private and public sectors. Members receive a range of services including the monthly Audit & Beyond newsletter.
5. The Financial Reporting Faculty is recognised internationally as a leading authority on financial reporting. The Faculty's Financial Reporting Committee is responsible for formulating ICAEW policy on financial reporting issues, and makes submissions to standard setters and other external bodies. The faculty also provides an extensive range of services to its members, providing practical assistance in dealing with common financial reporting problems.
6. The ICAEW Middle East Region is headquartered in DIFC, Dubai and provides support to over 1,200 members and students. It works closely with governments, regulators and key stakeholders, for example assisting the DFSA in audit quality monitoring, working with Hawkamah to increase awareness of the importance of good corporate governance and producing thought leadership and technical events for members and non-members.
7. The Financial Services Faculty was established in 2007 to become a world class centre for thought leadership on issues facing the financial services industry acting free from vested interest. It draws together professionals from across the financial services sector and from the 25,000 ICAEW members specialising in the sector and provides a range of services and provides a monthly newsletter FS Focus.
8. We currently perform a role for the DFSA in providing assistance to the DFSA Audit Monitoring Team. Therefore we have an active and informed interest in the development of the audit regime in Dubai.

MAJOR POINTS

Support for the initiative

9. We welcome the proposals contained in the consultation paper which seeks to update and improve the regulation of auditors and keep the audit oversight structure of the DFSA in line with international best practice. We note the specific examples of DFSA drawing on the developments in individual countries and bringing them to bear in the Dubai financial environment on a proportionate risk based and sensible basis. In our view the steps being

taken will enhance the oversight of audit in Dubai and aid the provision of a sound investment environment.

10. We would however add a note of caution in the way certain areas are being approached. By being over-prescriptive in these areas the DFSA may inadvertently be limiting the access to the role unnecessarily and forcing types of conduct which may not always be appropriate to individual circumstance. We have therefore suggested in response to a number of questions that a high level principles approach should be adopted, with the rules adapted as illustration of those behaviours rather than having them as an absolute requirement.
11. The accountability of the principals although a welcome development in transparency, can have some conflicting side effects which need to be considered in parallel with these proposals and a suitable response developed for these. In particular the oversight over the whole firm, and the potential civil liabilities of those concerned need to be carefully considered.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

Q1: Are there any objections to the proposed introduction of the registration of principals? If so what are they?

12. The registration of Principals is a step followed in the UK under the Companies Act 2006. The process is part of the audit quality objectives to ensure that those that carry out the work and express the audit opinion are adequately qualified and personally called to account where the standards of delivery fall short. We believe that the approach compliments the previous rules in this area and should enhance the quality of audit opinion.
13. However care will be required to ensure that the added responsibilities do not bring with them a greater risk of personal liability. We would draw attention to the safeguards contained within the UK Companies Act 2006 section 504(3) for example which exempt principals from civil liability associated with signing off individual audit reports. These safeguards are not immediately apparent from similar new obligations set out in AUD 6.2.2.
14. The registration process is part of a two tier process where both firm and individual are regulated. However the prime responsibility for the quality of the audit rests with the firm. We note the proposal to make direct intervention with the principal rather than the firm by the DFSA but the basis for such interventions is not clear. In our view the key control point is through the firm and the accountability runs through the firm, and the DFSA should approach the firm in the first instance on all regulatory matters. Otherwise it weakens the firm's accountability and the obligations of the compliance partner.
15. The proposed transitional arrangements refer to the automatic registration of principals known under existing arrangements, then the requirement for a follow up within 60 days. This seems an unnecessary additional burden for the firms, and the timeline should be aligned with that of renewal of the annual registration of the relevant firms

Q2: Are any difficulties anticipated in meeting the proposed amendments to the criterion relating to the experience of an Audit Principal? If so, what are they and how should they be addressed?

16. The high level technical requirements and skills needed by an audit principal over and above those set out in the Glossary for a Recognised Professional Qualification are not clearly articulated in the proposals. Rather the proposals are a series of tactical steps which a principal would need to adhere to in order to qualify. As a consequence this tick box approach in our view is over-prescriptive and could lead to the exclusion of a number of suitably skilled people who taking all things into account, should be adequately able to fulfil the role at the necessary quality standards.

17. As an example the requirement for five years' relevant experience in the last seven looks very demanding prima facie (although we note that other jurisdictions who set this requirement are referenced) but fundamentally this all begs the question as to how 'relevant experience' is to be defined. The UK has a strict definition of less experience which a lot of students and members struggle to meet; this more arduous requirement would exclude even more.
18. The insistence on recent experience potentially excludes lots of good people who have taken career breaks or secondments to different organisations and work functions. It may be intentional to apply this exclusion and there may be appropriate risk factors influencing this approach, but if quality rather than recent technical knowledge is the over-riding objective then this obligatory factor could contribute to a lesser quality cadre of principals than otherwise have been the case.
19. A further example is the guidance at AUD 2.4.2 which makes reference to the time periods requiring "relevant audit experience". This is rather an open-ended definition which in itself may unnecessarily narrow the ability of auditors to take on audit roles. This because it implies for example specific industry experience which may not be necessary to be able to express a satisfactory audit opinion. A term such as "appropriate" or "commensurate" may convey the necessary audit experience levels without weakening the underlying quality requirement
20. We believe that the experience rules would be better expressed as a principle under which a number of factors would be taken into account including the 5 out of 7 years, but would not in themselves in isolation lead to exclusion. This principle based approach would in our view better serve the aims of the legislation.
21. In connection with setting out the sought for characteristics it may be worth reviewing the content and the responses to consultation around draft guidance IES 8 drawn up by the IAESB in relation to the competence requirements for principals. This document in its original form and in its second iteration was challenged by the professional bodies as being over – prescriptive and failing to identify at sufficient high level the key requirements by including content which better served as an illustrative appendix. We believe the learning associated with that consultation may be relevant to the approach here.

Q3: Are the DFSA powers to suspend and withdraw the registration of an Audit Principal appropriate? If not, why not?

Q4: Is it appropriate that either the Registered Auditor or Audit Principal may apply for the withdrawal of an Audit Principal's registration?

22. These powers are in our view essential for the effective oversight of the professional service and for protection of the consumer. A balance has to be achieved recognising the rights of the individual as an audit principal and their access to an appeal around the regulatory decisions, but at the same time if there are seen to be high risks associated with the continuance of that person in the role of audit principal then the oversight body has an overriding obligation to intervene. A similar approach is taken by ICAEW in its Audit Regulations.

Q5: Are any difficulties foreseen in meeting the proposed requirement for the mandatory rotation of an Audit Principal of a PLC?

23. As is noted in the explanatory text, the rotation of audit principals is an accepted form of best practice across most audit regulatory environments. The rotation is an important aspect of audit independence which is considered by some to be more effective and less disruptive than mandatory firm rotation.

24. It is recognised that there is a challenge for the smaller firm which has only one or two audit principals as to how this is effected, and this may be a more relevant issue in Dubai. However, given the underlying regulatory objective around audit independence, the rotation of firm where there are insufficient qualified audit principals is likely to be the most appropriate outcome..

Q6: Are there any objections to the proposed prohibitions on non-assurance services that may be provided by firms also engaged in providing assurance services to the same client? If so, what are they?

25. The appropriateness of a prohibition on non-assurance services, and what services might constitute non-assurance services, has been the subject of intense debate for many years, most recently in Europe as part of the European Audit reforms.
26. The view of ICAEW has been to ask that any approach adopted in the EU be consistent with what was being recommended under international standards through IESBA so as to enable international audits to be conducted without the complexity of multiple jurisdictional assessments on what services could and could not be performed. Against this backdrop the guidance given for Article 105(2) is wholly consistent with this preferred approach and in our view the appropriate assessment to ensure independence of the auditor.
27. There is sometimes argued to be a tension between the use of prohibited services alongside a requirement for auditors to assess threats and apply safeguards on other non-assurance services. However this approach has been followed internationally and in other jurisdictions and was the subject of intense debate in Brussels. We believe that the key risks should be addressed through the threats and safeguards route, but acknowledge that in the interest of public oversight and confidence, an approach that is independent of the judgement of auditors – typified by a prescribed list of prohibitions - resonates better with public perception

Q7: Are there any objections to the proposed permitted activities during the suspension of a Registered Auditor's registration? If so, what are they?

28. The question seemed to be phrased on a basis slightly inconsistent with the content of the paragraph which concentrates on activities that are not permitted. The approach taken is consistent with that followed in the UK under ICAEW's own Audit Regulations. There is however a possible difference in scope; the DFSA rules seem to be limited to audit opinions for Domestic Firms, PLCs or DFs whereas the ICAEW rules preclude a suspended audit principal from issuing any audit opinion irrespective of type of entity. It appears strange to us that some forms of audit might still be permitted but there may be circumstance to which we are not privy where this approach is appropriate.

Q8: Are there any difficulties foreseen with the maintenance of Working Papers from jurisdictions outside of the DIFC?

29. The success of the requirement for firms to maintain working papers in jurisdictions outside the DIFC will depend on a number of factors which in turn will depend on the relationship that DFSA has with the regulatory oversight bodies of other countries and the legal relationship between the firms performing the work on the parent and subsidiary entities. There may also be issues of commercial confidentiality within states that inhibit this access.

Q9: Does the nature of fees proposed (i.e. flat and variable) seem appropriate? If not, why not?

Q10: Does the level of fees proposed pose any significant concern about the commercial viability of Registered Auditors' operations in the DIFC?

- 30.** We have insufficient knowledge of the cost and affordability of the DFSA's operations and the charges to firms to comment in detail on the proposals. However we know from experience that the fairest charging mechanism is often the most expensive and complex to administer, and therefore a satisfactory medium has to be achieved between simplicity and fairness. Provided the approach taken is transparent and there is a sensible rationale in the tiering of fees then the firms involved are more likely to be supportive of these sorts of proposals.
- 31.** We note the current tiering proposals seem to have quite marked steps in their formation. Where these tiers are marked these can engender unintended behaviours including the refusal to take on audit appointments or the shedding of appointments thus causing supply and competition issues for the audit service. It can also affect the underlying insurance market and the premiums applied for Professional Indemnity Insurance. Arguments can arise about the timing of qualifying period assessed for the quantity. Care is therefore required in the setting of tiers that do not appear penal in their steps.
- 32.** We would also add that it is important that an approach is adopted that can be sustained and bought into by the regulated firms on an year by year basis. Varying rates of increase above and below the inflation level can engender energetic debate and deflect from the underlying initiatives an oversight body is wishing to develop. Provided the approach taken is transparent and consistent and there is a sensible rationale in the tiering of fees and of any inflationary led annual increase then the firms involved are more likely to be supportive of these sorts of proposals."
- 33.** Linked in to this is the interesting suggestion of a full public consultation on any change in fees in future. We are not cognizant of the volume of work involved in such a process, but it seems like quite a heavy burden if for example there was a wish to push up fees by 3%. The DFSA may be holding itself out as a hostage to fortune and should perhaps seek to apply a more pragmatic approach that the firms are comfortable with but does not over-burden the Authority, This could perhaps take the form of only requiring a consultation where there was an initiative to increase fees by more than say 5% in any one year.

Q11: Is the proposed option for select firms in Prudential Categories 3B, 3C and 4 to apply IFRS for SMEs appropriate?

- 34.** The IFRS for SMEs has been introduced in a number of countries, including the UK, as the full IFRS is a disproportionate requirement for many small businesses where there is low consumer and investor risk. The proposals here appear to align the basic guidelines given by the IASB with the infrastructure operating in the DIFC, and therefore seem to be a reasonable and practical introduction of this form of financial reporting.
- 35.** We note the power for the DFSA to direct at its own volition where the use of the IFRS SME may not be appropriate and for a full IFRS to be applied. Whilst we agree this is a reasonable power for the DFSA to hold, it needs to be applied consistently and on a timely basis, and not place exceptional financial burden on both the entity and the auditor especially where the work on a specific financial period has already been completed under the lighter standard.

Q12: Do you have any comments on the DFSA's proposals to amend GEN 8.6.3? In particular, do you think there are further public interest arguments for requiring all firms to disclose, on request, their financial statements? If so, what are those arguments?

Q13: Should GEN 8.6.3 be applied differently for Branches? If so, how should the Rule be applied?

36. There is some merit in the rationale of exempting the categories listed if that same category is entitled to report its financial results under the IFRS for SMEs. There is then a consistent view of those entities as being low risk and generally of small interest to most individuals in the state.
37. However there may be a different view applied where there are a significant number of shareholders, for example in a mutual, or where a large number of consumers may have a dependency on the supplies from certain entities, such as utility operations, where state intervention would be necessary in the event of corporate failure. Therefore whilst there does not need to be a blanket requirement for entities in these categories to disclose, there may be a group of them with attributes outside those of financial services that should have this requirement.

Other observations on the draft audit code

38. The Consultation Document has set out 12 basic questions on various aspects of the draft amended code. However there are some other areas of the proposals which we believe also warrant some further comments. These are set out in the following paragraphs.

Continuing obligations (AUD 2.3)

39. We note with approval the requirement for registered auditors to comply with international standards under AUD 2.3.1(a). However the obligation on 2.3.1(b) and indeed elements of the registration associated with this around procedures and monitoring (2.2.3(c) to (e)) appear to us very demanding, especially for the smaller firms where the client profile may mean the risk is much lower. We note elsewhere the proportionate approach that is being taken with regard to accounts disclosure and the use of the IFRS for SMEs. This approach is not replicated here with the standards that are being imposed.

Principles for Audit Principals (AUD 2.6)

40. The code sets out at section 2.6 rules based on the IESBA code which should be applied by principals in the conduct of their audit work. Whilst we consider these to be useful illustrations against which the principal could operate, the application of definitions to these rules, which are not themselves consistent with the IESBA code, means that principals may find themselves having to operate to two different codes with the consequent confusion.
41. In addition some of the criteria used in the definitions, such as “bias”, are highly subjective concepts which are difficult to define and direct personal conduct. We believe that the code should not be so prescriptive in this area but rather base the principles around the content of the international code.

Working papers (AUD 4.4)

42. If we understand the aims of the drafting correctly, this section appears to be attempting to define audit quality and the means by which this may be measured and monitored. Audit quality is a complex subject and has a number of dimensions which are regularly being explored. ICAEW in its recent papers and through its Audit Quality Forum set up in 2004 is regularly providing indicators and methodologies to improve audit standards. To simply address audit quality in terms of availability of working papers in certain quantities is in our view insufficient and inappropriate in order to achieve the desired standards of quality in the audit opinion.
43. We also find the term used - “sufficient” working papers - to be highly subjective in itself. This a further adjective in the code which we believe would be difficult to monitor and enforce. It is a word that can denote minimal standards when perhaps higher should be delivered, or it can be viewed as a completeness requirement in which case it could be demanding maximum standards. Also different people may take differing views around what may constitute completeness putting overseer at odds with principal and firm.

- 44.** The approach taken by ICAEW in its audit regulations is to follow the definition for working papers set out in SI220 2010 of the Irish government’s enactment of the Statutory Audit Directive 2006. This defines working papers in article 3(a) as follows

“audit working papers”, in relation to a statutory auditor or audit firm, means material (whether in the form of data stored on paper, film, electronic media or other media or otherwise) prepared by or for, or obtained by the statutory auditor or audit firm in connection with the performance of the audit concerned, and includes—

- (a) the record of audit procedures performed,
- (b) relevant audit evidence obtained, and
- (c) conclusions reached,

- 45.** This definition is not prescriptive in the form those working papers should take, but rather draws on the requirements associated with Internal Auditing Standards which are seen as the main driver for achieving the audit quality objectives that appear to be behind 4.4.1. We believe drawing on those standards and perhaps some of the wording above may achieve a more cohesive and practical rule around the quality of the audit evidence needed both internally and cross-border.
- 46.** We also note the requirement for registered auditors to supply copies of working papers to the DFSA when it should request. This is not an unreasonable request for an oversight body, but it needs equally to be measured and practical. The term “prompt” does not lend itself to those concepts and a more flexible timescale with a longer cap may be a better way of expressing this, so that the process does not significantly disrupt a firm in its conduct of other audit and client work.
- 47.** We understand that the IAASB are due to issue their Audit Quality Framework document during the course of this month. This may have some content relevant to the objectives that the DFSA is trying to achieve here and which might address some of the concerns we note above.

Annual Return (AUD 4.8)

- 48.** The annual return is a valuable tool for a regulator to monitor its licensed bodies and to identify key risk areas. It is a tool ICAEW uses with its members across a number of facets. It is however a document that without checks can easily develop into a lengthy and arduous obligation, and thereby a telling overhead for firms, who then question their presence in the market when they have only a few relevant audit clients. We ourselves have to be clear with our members the reasons why we seek certain data elements and ensure their collation is not over burdensome.
- 49.** It may therefore be appropriate to revisit the content of the DFSA return to ensure it is proportionate and relevant, and to establish from firms where the requirements are demanding so that their continued requirement is evaluated and alternative data content considered

Anti-Money Laundering (AML) (AUD 4.9)

- 50.** The Guidance refers Registered Auditors to obligations contained in the DFSA’s AML Rulebook. This rulebook defines “Relevant Person” to include an Auditor and places on the Auditors the same obligations as applicable to any Authorised Firm, as far as AML is concerned. Since Auditors provide services only to DFSA Authorised Firms (which would mostly fall within the definition of a Prescribed Low Risk Customer), it appears to us unnecessary and highly disproportionate to require Auditors to comply with the AML standards applicable to other financial service providers.
- 51.** The requirement to submit a comprehensive Annual AML Return is also time-consuming and burdensome for the Auditors and seems inappropriate for firms with little risk and exposure to this.

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