IN COLLABORATION WITH

The changing role of Audit

White Paper

Introduction

The concept of transparency and rotation has been a long standing debate in relation to the audit market both within the UAE and globally. More recently, there have been developments globally, particularly in the EU with the recent audit reforms being introduced to promote transparency and independence. This debate has led to many other emerging economies embracing the notion of the need for such reforms especially in countries where commercial decisions are predominately relationship focused.

In many economies having audited financial statements is a mandatory requirement. The auditor is required to be independent from the management team and board to ensure they remain equitable and can provide a precise, uncompromised and comprehensive view of the company's financial position. Over time a working relationship is established in which some cases can translate further. These relationships can transpire beyond decades especially within a family owned business where the relationship is passed from one generation to the next, equally the same could be said for a corporation where the audit relationship has been established for years and therefore, change isn't seen as necessary.

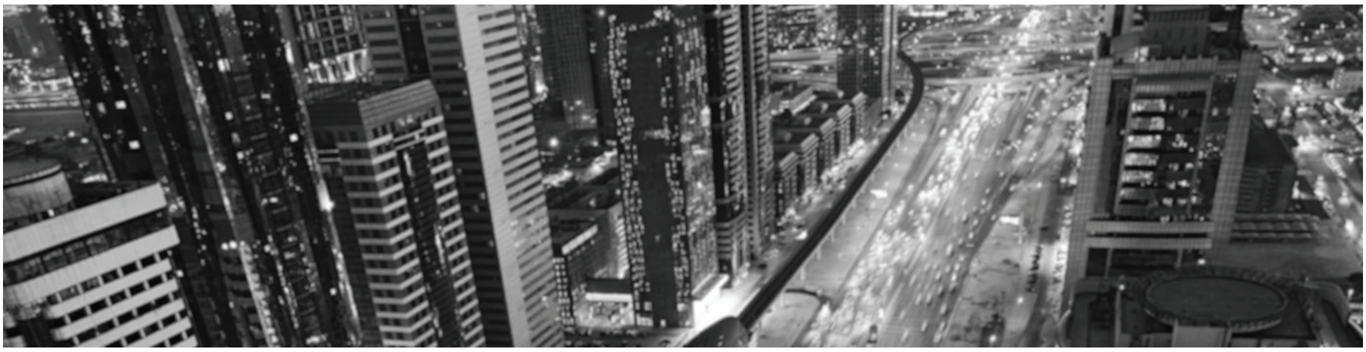
The recent EU reforms have illustrated the importance of the need for audit rotation and the debate has pushed this topic up the agenda of investors and large company boards. It is clear that some companies have noted the concerns and are already reacting to the EU reform.

More recently, Abu Dhabi Accountability Authority (ADAA) has taken the first step by announcing that it is mandatory for any company regulated by ADAA to rotate their auditors every four years (announced 11 Oct 2014) under the Statutory Auditor Appointment Rules (SAAR). Under SAAR regulations, all subject entities including Abu Dhabi government public entities and state owned enterprises in Abu Dhabi must comply. This change has been taken to further promote transparency and accountability in the local market. ADAA announced that "the objectives of the rule are to regulate the process of appointing the statutory auditors across all subject entities, which includes all Abu Dhabi government public entities and state owned enterprises[1]."

This mandatory rotation is a significant step in the right direction for the Emirate in relation to the current audit market. The new Federal Law No. (2 of 2015 on commercial companies (article 243) as released in 2015 stipulates that all PJSCs (public joint stock companies) must have one or more auditors nominated by the board of directors / managers, and approved by the general assembly. In addition, the general assembly may appoint one or more auditors for one renewable year, provided that such term does not exceed three consecutive years, promoting the need to rotate.

Given the level of change and the enhanced requirements currently in progress within the Audit landscape within the UAE, it is inevitable that the role of audit is set to change. This change will not only transpire to enhanced economies, but will also be reflective in emerging economies including the UAE. This change has led way to discussions on the topic of the 'future of audit' and the increased demands from business stakeholders who seek not only an audit report, but a value addition report.

Grant Thornton and the ACCA took the opportunity to host leading individuals from regulators and banks to highly acclaimed CFOs who represented family owned businesses, SMEs, listed companies and sovereign wealth funds amongst others, to discuss the changing role and 'future of Audit.'



1 Abu Dhabi Accountability Authority, accessed via http://www.adaa.abudhabi.ae/En/MediaCenter/News/Pages/SAAR2014.aspx on 2 June 2015

Leading future discussions

The UAE has a diverse economy which is challenging international markets, but what does this mean for companies and their audited financial statements? What regulations and legislations are taking place globally and locally further promoting change within the industry? These are some of the questions that the audience addressed during the insightful discussion which was attended by some of the largest leading businesses in the UAE.

The roundtable discussions found that the independence and strength of the audit committee is key and that the overall strategy of the business should be digested to further drive the way forward for the benefit of the organisation, which will also allow the committee to recognise any lapses in control. The audience also touched on the practical challenges of the upcoming long form report with regulators looking to hold awareness sessions to address this concern.

The UAE is fast becoming a leading economy recognised world over for exceeding expectations and innovating the future. What needs to be done within audit to ensure the needs of growing businesses are met and that the current standard auditing approach of delivering financial statements is reformed?

The audience stated that the role of auditing needs to encompass a 'trusted advisor' approach whereby the auditor becomes a strategic partner to further unlock their growth potential and solve any complex issues which may arise, of course within the ethical boundaries. One participant from a large local bank stated "In the last three years, I have really seen the audit committee put me on my toes. The questions which they ask at times add real value, and that I think is the crux to the future of audit."

When hosting the same roundtable in Abu Dhabi, we found the audience had a differing perspective on the future of Audit which was an interesting analysis. Although they translated the same lack of awareness in relation to the long form audit report, they did highlight that there is a need from key stakeholders to know more than just the 'financial numbers' of the organisations. There is a need for analytical audit in the market to allow stakeholders to gain a clearer picture of the health of the business, which will allow for greater industry comparative measures. One participant from Abu Dhabi stated "The long form audit report is really an evolution of the existing audit reporting structure. The current reporting structure may not communicate all the real issues but with the new long form audit report structure businesses will have more information on the key issues."

The Abu Dhabi roundtable also stressed that there is a need for auditors to be professionally qualified in the UAE and the professional accountancy bodies have a role to play in supporting the qualified auditors to ensure they have the knowledge of the relevant audit rules and regulations in the country.

The roundtable then touched on the element of audit rotation, the audience discussed the current EU reform and the prospective of such regulation in the Emirate. Although this reform is set to change the landscape in Europe, bringing about positive change, the notion of such reform in the Emirate was met with slight hesitation. Given the demographics of the country and that business in the UAE is predominately conducted based upon long standing business relationships where trust is built over the years, the notion of audit rotation every four years was questioned within the Emirate. Rotation was seen to pose a challenge in complex businesses where auditors may need a number of years to familiarize themselves with the organisation, so the requirement to rotate after four years may pose difficulties.

Leading CFOs discussed that during the course of the audit, the auditors are given the opportunity to truly understand the business. After four years, the auditor is has built an understanding which enables them to have a true reflection of the business which can uncover key growth areas or elements to consider. If this was rotated, the level of analysis and getting 'deep under' the business may prove extremely challenging, possibly not providing the same level of results that a more long standing auditor could have.

That said, it would promote the level of transparency and governance, this change would also promote competition amongst different audit firms with the market mechanism moving to a supply and demand model. By rotating the auditors; the previous auditors can provide certain consultation and advisory services that were prohibited due to the conflict of interest. This would provide the business irrespective of sector with different views on its financial and operational cycles.

UAE Perspectives

Given the topic of discussion, highlighted below are some key takeaways from the roundtable which provides elements to consider, further shaping the future of Audit within the UAE.

- There is a need for all the regulators and key impacted stakeholders to align in advance of the introduction of the long form audit reports in 2016 to ensure that the market is fully prepared.
- Corporate entities deserve more than just a standard audit report, therefore long form audit report is going to be more meaningful communication. However there are going to be debates on what needs to be included in these reports.
- The independence and strength of the audit committee is key, they must understand the management strategy and business so that they can drive the way forward for the benefit of the organisation and recognise any lapses in control. There was seen to be a gap between the competence and capability of some audit committees in comparison to what it was felt was required to truly deliver their role. It was suggested that there may need to be regulation around eligibility criteria for Board Member nominations or mandatory training.
- Demonstrating the value of audit is key, it shouldn't be just a checklist approach and underpinning the audit quality has to be competent professional qualified auditors who have experience and understanding of the business that they are auditing. Those that have the authority to sign the audit report should be chartered or certified public accountants.
- It is critical that audit remains independent but it was generally felt that it can and should play a role in delivering insight into improving business both in terms of opportunity and risk that could help ensure greater business success.
- Four years for mandatory audit rotation was considered too short.
- Auditors should act as business partners and help the corporate entities in growing their business and identifying possible areas of growth, all within the independence boundaries.
- Innovation was highlighted as a must in auditing techniques and standards to make the audit more productive, practical and trusted.
- Automation of audit was said to be necessary to further promote efficiency. With the sophisticated tools used by corporate entities, it was said that audit should take advantage of business intelligence and focus on testing IT controls more than going into old style vouching techniques.
- It was found that professionals from the banking sector are more interested in reviewing future business plans and accounts rather than only relying on historical audited accounts. Therefore auditing standards should cover the requirements of the lenders, who are key stakeholders, to provide comfort over future business plans.
- Audit committees need assistance from the auditors in terms of providing a detailed insight of business, controls, risks, policies and procedures. A standard audit with standard points in the management letter would not suffice the future requirements. Rather an insightful and detailed management letter would add value to the corporate entities and will raise the respect of the audit process.

In contrast, discussions with key stakeholders in Abu Dhabi highlighted the following:

- Awareness of the introduction, obligations and impact of the long form audit report on listed companies in 2016 needs to be improved, all stakeholders play a role in this including government, regulators, firms and professional bodies.
- There is a lack of consistency in the quality of auditing, which risks undermining the case for the value of audit
- There is a market need for more context and information about the financial health of businesses, audit could form part of this but is currently not seen as the tool to give stakeholders that information
- We need to build awareness of the value of audit at the top level of organisations, in the context of overall business performance
- Those organisations that are currently not required to have an audit represent a huge grey area in the business performance of the economy
- Boiler plate audit reports are not seen as helpful as these do not distinguish between a weak and a good audit.
- Output of audit is vital for the stakeholders, therefore a detailed and timely communication from the auditors is needed covering the business perspective.
- Corporate entities are looking for the right advice at all levels. Advice from the auditors should not be a 'one size fits all' but tailored as per the size of the organisations for example SMEs have differing issues than a multinational.
- Right level of qualification of auditor is a key to a successful and productive audit.
- Audit planning should be robust to understand the business well instead of only ticking the boxes. Auditors must think outside the box and related standards should allow the same to really have an effective and efficient audit.

Some of the challenges identified for the future of audit were the use of technology and whether it is fit for purpose as the profession evolves. This included moving from historical financial statements to integrated reporting. The participants also stated that at present audit is trying to be 'all things to all people' but there is a risk that one standard report doesn't meet the needs of all the different stakeholders and there could be a requirement for different reports for different purposes. There is also the challenge of increasingly complex businesses and the ability of the audit functions and providers to keep up with those changes.

The future of Audit for SMEs

With SMEs being a key business group within the UAE, representing 40% of the Emirates GDP[2] which is set to continue growing with the level of investment in innovation and Expo 2020, the future of audit will inevitably impact this imperative business group. A participant stated "SMEs need to look at auditors as advisors who can highlight the growth potential of the organisation."

Advances in technology and access to information have changed the audit landscape over recent years. This has allowed SMEs operating in the UAE to gain further insight to key issues and industry best practice. However, as the market becomes much more competitive and access to information soon saturates with all SMEs having access to the same level of information, the perspective and analytic view which an independent auditor can provide can be instrumental.

Greater transparency, exposure to real insights and the ability to identify future growth prospects are all advantages that an audit can provide. The notion of audit rotation may prove to be more beneficial for a SME where differing viewpoints of the business are presented every four years further enhancing the access to tangible knowledge and industry best practice, which can lead the way to growth.

When we look at 'small' businesses, one of the participants stated "many simply don't have any kind of audited accounts whatsoever. It's all on random Excel sheets fragmented across different units of the business but one of the ways of changing that is by bringing a fresh generation of people into the business and our best shot of bringing a new generation in is through Emiratisation bringing in people who are fully aware with a fresh-start mentality and a fresh-start perspective who are fully aware of the umbrella of financial strategies that are required." This interesting viewpoint, could also lead to change and further promote the importance of having an audit regardless of size – which opens up the question of making audit mandatory as has happened in leading economies such as the UK. Could this be a viable solution in the future?

The future of Audit for Family owned businesses

Family owned businesses within the UAE represent a large proportion of the business demographics in the region. These businesses were established by visionary leaders and entrepreneurial families when the UAE was still in its foundation.

A key focus will be on institutionalizing the legacy and building new strategies to meet the opportunities and challenges of a new dynamic market. We are already seeing many family businesses investing in strategy and operational efficiency as well as expanding into regional and global territories. IPO's are also a considered alternative. To continue growing with the UAE, the importance of an audit within family owned businesses especially those looking to IPO in the near future, is key. With innovative measures being considered for the future of audit, it could provide the dynamic perspective that these legacy businesses would be looking for when setting their growth strategies, not only within the UAE but globally too.

However, the notion of audit rotation may prove to be a difficult element to embrace given family owned businesses are built on the notion of trust and relationships. If audit rotation became mandatory in the future, family owned business may be less inclined to divulge information as they would be to a 'trusted advisor'. Another element mentioned by a participant was the element of corporate governance, he said "the 2013 Companies Act - defines 13 constituent elements each of which carry criminal proceedings if breached but it doesn't define governance as such." Another added in support of this statement "how robust is the audit of corporate governance within family owned businesses, corporate governance is probably far too distant in the future but these are things which I think in this region will drive the future of audit," further promoting the notion of transparency and thus embracing the notion of the benefits that rotation can provide.

2 Dubai SME, accessed via http://www.sme.ae/about-us on 2 June 2014

The future of Audit for Listed companies

The notion of audit rotation would provide great benefit for listed companies. The level of increased independence as a result of such rotation would lead the way to further investor confidence. Increased investor confidence bodes well for listed companies, which would further aid growth. Although the audit relationship would be changed every four years, this would in turn promote greater transparency which is fundamental for a listed company.

More recently, the new Federal Law No. (2 of 2015 on commercial companies (article 243) as released in 2015 stipulates that all PJSCs (public joint stock companies) must have one or more auditors nominated by the board of directors / managers, and approved by the general assembly. In addition, the general assembly may appoint one or more auditors for one renewable year, provided that such term does not exceed three consecutive years, promoting the need to rotate.

This in term is set to promote fair competition, transparency and promote independence which will only continue to promote investor confidence that in turn will ripple positive return for the stock market and the economy as a whole. With the EU reforms bringing this important subject to the board agenda, it is said that it is only a matter of time before the audit market changes internationally for the betterment of stakeholders, boards, investors and the wider economy.

The future: The changing role of Audit

The insightful discussion led way to a futuristic view of the future of audit and how this should no longer be seen as a tick box exercise, but more so a value added partnership which is necessary for organisations who are truly looking to grow and achieve their growth ambitions. Validating this, a participant from the Abu Dhabi roundtable stated “Predictive data is important. Clients are now looking for what’s happening and changing in the business. There is a need for more information. More relevant information.”

Innovative solutions and the advance of technology would enable external auditors to benchmark the companies they audit against sets of data from across industries which will give them greater information on any potential risks. With access to such data, it will enable the auditor to translate this to their clients business which could provide leaders with valuable perspectives and insights that they can use in their business to further promote growth.

Alongside this it will provide value for capital markets in enhancing investor confidence and thus promoting economic growth. As the Gulf region assimilates into the global marketplace, corporate governance plays a dynamic role in improving the transparency, accountability, competitiveness and the notion of succession planning. Countries with a strong corporate governance culture attract greater domestic and foreign direct and portfolio investment.

Realising the benefits of good corporate governance, central banks and capital markets in the GCC countries are developing corporate governance frameworks to advance a globally competitive corporate structure. However, as the region is still young in terms of business environment, several measures are being taken to improve the implementation process of good governance. Appointing and choosing an auditor is a critical decision and commitment for any organisation, as you are more than likely making a long-term decision and choosing a company that will contribute significantly to the success of your business over time.

Whilst choosing the external auditor, audit committees should ask two important questions to which answers will have to be found in the selection process in accordance with the company’s specific circumstances, they are as follows: what is deemed as a quality audit? And what is the value of an audit?

This was further highlighted in the roundtable with one participant from one of the largest sovereign wealth funds stating, “For me, it’s the value of the audit. Do they understand, is there an acceptance, is everybody aligned on what the purpose of the audit is, do they really value it? Some companies have to do it, others value it because they want to understand how the company is performing, so they can make comparisons before they make an investment.”

In agreement, another participant from one of the largest real estate and construction companies in the UAE stated it is not just down to the regulators or a particular body but a collective commitment stating “it is absolutely important that the audit profession must maintain very high standards of integrating independence and the quality of audit and it not only depends on the authorities, the regulations, the institutions which govern the professional qualification, it also depends on each of the firms, the audit firms themselves. How much they adhere to those principles and maintain the quality of work that they do. I would say that Grant Thornton has done well in keeping those standards high and I think that is what would take the profession higher" moulding the future of audit.

Recently, changes such as the European Parliament's approval of the Regulation and Directive to reform the European audit market, supported in substantially addressing investor concerns over auditor communication, long tenure, and excessive volume of non-audit services.

European investors called for change to the large company audit market, particularly with regard to concerns that long auditor tenure and the provision of significant levels of non-audit services by the auditor are compromising audit quality (compromised independence and reduced professional skepticism). Such developments and changes to the audit environment continue to alter and shape the audit approach impacting organisation's in the decision making process.

Regulatory bodies in the UAE have already been thoughtful in regards to the auditors' independence and related rotation, consequently the step taken by the European Parliament will certainly provide a platform to the Regulators in bringing reform to the local market and making the auditing profession truly independent and robust to further measure business performance.
As one participant operating within financial services stated "regulators need to be in sync with one another for evolving methodology in the future, that's important". Taking into consideration the feedback from the roundtable and the topic of the future of audit, the decision of selecting the most appropriate external auditor for your organisation has never been more important than before[3].

Contact us

Grant Thornton UAE
Rolex Tower, 23rd Floor,
Sheikh Zayed Road,
Dubai,
United Arab Emirates

T: +971 (0)4 388 9925
E: info@ae.gt.com

www.grantthornton.ae

ACCA
Dubai Knowledge Village
Block No. 19
Office No. S01
Dubai

T: +971 (0)4 391 5451
E: info@ae.accaglobal.com

www.accaglobal.com

3 *Finding the right external auditor written by Khurram Bhatti, Assurance Partner accessed via http://www.grantthornton.ae/page/finding-the-right-external-auditor on 2 June 2015*

About Grant Thornton

Grant Thornton is a leading business adviser that helps dynamic organisations to unlock their potential for growth. Our brand is respected globally, as one of the major global accounting organisations recognised by capital markets, regulators and international standards setting bodies.

Over the last three years we are the fastest growing large accounting organisation and we are constantly evolving and developing alongside our clients'.

Grant Thornton UAE is a member firm within Grant Thornton International Ltd. Grant Thornton UAE has been providing assurance and advisory services to growth oriented, entrepreneurial companies which are based in all markets and industries since 1966. The extensive local and regional knowledge gained through the years has supported the development of the firm's reputation for providing a distinctive client service to its local, national and international client base.

The firm adopts best in class international tools, methodologies and independence/ risk management standards across all service lines in order to ensure the service provided is to the highest technical, professional and ethical standards for the benefit of all its clients.

As a $4.7bn global organisation of member firms with 40,000 people in over 130 countries, we have the scale to meet our clients changing needs, but with the insight and agility that helps them to stay one step ahead. The firm's mission is to be the adviser of choice to dynamic businesses, whilst being known as a bold and positive leader in its chosen markets.

About ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. It offers business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

ACCA supports its 178,000 members and 455,000 students in 181 countries, helping them to develop successful careers in accounting and business, with the skills required by employers. ACCA works through a network of 92 offices and centres and more than 7,110 Approved Employers worldwide, who provide high standards of employee learning and development. Through its public interest remit, ACCA promotes appropriate regulation of accounting and conducts relevant research to ensure accountancy continues to grow in reputation and influence.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. It believes that accountants bring value to economies in all stages of development and seek to develop capacity in the profession and encourage the adoption of global standards. ACCA's core values are aligned to the needs of employers in all sectors and it ensures that through its range of qualifications, it prepares accountants for business. ACCA seeks to open up the profession to people of all backgrounds and remove artificial barriers, innovating its qualifications and delivery to meet the diverse needs of trainee professionals and their employers. More information is here: www.accaglobal.com