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**"Developments in the Audit Profession:
Towards World's Best Practice in the GCC"**

My Dear Colleague, Abdulla Al Awar, distinguished speakers, panelists, fellow auditors, Ladies and gentlemen

Welcome to the first Regional Audit Seminar **"Developments in the Audit Profession: Towards World's Best Practice in the GCC"**

I am excited to see over 150 participants from all around the GCC. Thank you, speakers and panelists, for joining us. In particular, I would like to thank all you participants who have travelled to be here with us today and tomorrow, we really appreciate it.

This seminar is very dear to me. As a former auditor I feel a duty to promote the significance and impact of this profession and the importance that should be placed on auditors and the audited. This seminar was created to bring to light today's challenges and to highlight the different attitudes towards auditors before and since the crisis.

Auditors today carry greater weight and expectations compared with the past and here in the Middle East, which contains some of the fastest growing and swiftly recovering economies, we felt it was important to encompass how we can keep abreast of evolving international audit standards and how we can adopt them in here in the GCC.

Our leaders have already signaled its significance. Recently the UAE Minister of Higher Education and Scientific Research, His Highness Sheikh Nahayan Mabarak Al Nahayan referred to the importance of the highest standards for the nation's accounting profession.

The profession has emerged from its latest crisis battered and bruised. In the time-honored tradition of reform following public crisis, the reforms implemented by legislators and professional organizations, such as auditor rotation and prohibition of certain activities for accountants, and external supervision, are important steps towards restoring confidence. But just as we feel that confidence is restored, we see another crisis. I will not go into the details of the implication of Global Financial Crisis (GFC) as enough was already been said and discussed about it. Major corporate collapses like Enron, World Com, Parmalat, Satyam, Lehman have one thing in common: accusations that the auditors were either complicit, negligent or both. There are lessons for all of us from these corporate failures.

The EU Green Paper on 'Audit Policy: Lessons from the Crisis' also acknowledges that robust audit is key to re-establishing trust and market confidence; contributing to investor protection and reducing the cost of capital for companies.

Can we do more to increase (if not restore) the confidence? My answer is 'Yes', in a number of ways, we can. '

The first of these is Independence.The debate surrounding the role of external auditors focuses in particular on auditor independence. The concept of independence is not the easiest to define. The definition, which I like the most, is the ability to resist client pressure.

And this particular definition would lead to a very important aspect of audit profession - namely self regulation threat.

An audit firm is required to establish policies and procedures to promote and to monitor compliance with independence requirements by any person in a position to influence the conduct and outcome of the audit. I would place particular emphasis on the word “monitor” here as the responsibility to monitor compliance also resides with the audit firm. The audit profession is largely self-regulated in most parts of the GCC. In the absence of an active regulator or a professional association, most audit firms are required to use their own judgements when dealing with independence issues. By judgement, I mean use of judgement in interpreting the standards which govern matters relating to independence.

Although the applicable standards (IFAC Code of Ethics for Professional Accountants) are very clear on the independence requirements and other restrictions, it is always beneficial to have some body looking over one’s shoulder. In this vein, you will have the opportunity to listen to David Damant and other panellists during the third session on “Independence, Ethics & Non-audit services”. Oversight on own independence cannot rest only with audit firms. It must be - and is - protected by effective oversight bodies such as the PCAOB / FRC including SCA and the DFSA and internationally International Federation of Independent Audit Regulators (IFIAR).

Another important area where independence plays a critical role is that of Initial Public Offerings (IPOs) and the role of auditors. This flows as a subset from the issue of independence. Global markets will return to an increase in IPOs, particularly here in the GCC where more family businesses are either going public or preparing to go public. Here an important question arises: What role should an auditor play when a client is preparing to go public? We have witnessed, at times, how auditors have become an important and reliable partner in the journey of a client from a family business to a public entity. Enron and World Com are glaring examples where the auditor grew with the companies and could not detach themselves from that growth. Where should the engagement partner detach himself from the process and an independent partner be introduced? Or should a different audit firm be introduced? I see a greater role for a professional body or a regulator to issue some guidelines with respect to the role of auditor in public offerings.

Another very important issue is the role played by the Board and the Audit Committee of the Board in the audit cycle.

The auditor, in discharging its day-to-day duties to the client, interacts mainly with the Chief Financial Officer and the finance / accounting function. All the key matters are agreed upon with them and are reflected upon in the financial statements. Matters requiring attention of senior management are discussed with senior management as well.

How often does an auditor interact with the Board and the Audit Committee of the Board? At times, the auditor may be captured by his the interaction with the senior management and neglect his ultimate responsibility to the shareholders, rather than management. It is critical that the auditors regularly meet with the Audit Committee of the Board and engage them in discussions relating to the Company's financial performance and their audit findings.

The International Standards on Auditing (ISAs) clearly require the auditor to communicate with those charged with governance. This is often done through a Management Letter or Internal Control Memorandum. These forms of reports provide increased investor protection.

I understand that there are certain forms of businesses where the management and shareholders are one and the same and communicating with them in either role would fulfill the purposes of the ISAs.

However, in other cases, the interaction of the auditor with the shareholders is restricted to the reading of audit report at the annual general meeting. Can this interaction be increased? My answer would again be Yes! Do we need increased interaction? I would again say Yes, we do!

In my opinion it is essential for all of us to remember that the auditor's responsibility is first and foremost towards the shareholders of the company and society at large and not exclusively to the management so it is critical that we communicate with those to whom we have our responsibility.

A further issue of independence arises with the question: Who should be appointing the auditors? Is it the CEO, CFO or the Board? In the past, I have been an advocate for forming a trust fund for appointment of auditors. Alternatively, another option is that the Board takes the leading role with the CEO and CFO providing support without being the ultimate decision maker. The CEO and CFO are involved with day-to-day handling of the auditor while the Board is in a more appropriate position to appoint an "independent" auditor.

Currently, there is an interesting ongoing debate in various jurisdictions over rotation of auditors. Countries such as Italy, Brazil, Malaysia, Singapore, and Korea already have an audit rotation system in place. Italy has a statutory requirement for audit firm rotation every nine years. In Brazil, companies have been made to change auditing firms every three years. In Singapore, banks are required to change audit firms every five years, but there is no requirement on listed companies. In 2003, Korea adopted the mandatory rotation rule and required listed firms to rotate their auditors every six years commencing in 2006.

A debate centres on whether it is better to rotate the audit partner or rotate the firm? What should be the rotation period: 3 years, 5 years or perhaps 7 years? I am of the view that rotation of the audit partner every 7 years appears reasonable, based on the cost associated in terms of acquiring the knowledge base.

In today's world, apart from independence, the biggest challenge is education; that is, training auditors to think independently. This training can only be achieved through operating in a culture of independence and trust.

Knowledge of the Code is essential but what is important is how you inculcate this code into your style of working.

It is very important for an auditor to maintain an attitude of professional scepticism and the firm should assist in establishing and maintaining this. An attitude of professional skepticism simply means that the auditor makes a critical assessment with a questioning mind, of the sufficiency and appropriateness of audit evidence obtained and is alert to evidence that contradicts or brings into question the reliability of documents or representations from management. That said, I am in no way suggesting that the auditor should be over skeptical or suspicious.

There is no universally accepted definition of professional skepticism. However, there are four sceptical characteristics which are of particular importance for an auditor. These are: interpersonal trust; suspension of judgement and need for closure; locus of control; and a comprehensive professional skepticism scale.

The basic concept is that if an auditor has a lower level of interpersonal trust he is assumed to be more sceptical. Skeptics particularly suspend judgements concerning whatever has not been checked. Similarly, auditing standards require an auditor to gather sufficient and appropriate audit evidence to the point that a reasonable conclusion can be drawn on which to base an audit opinion. The importance of locus of control (whether internal or external) has been widely recognised. The characteristics of a person with internal locus of control appear to be highly relevant for auditors' professional scepticism - in terms, for example, of accepting management assertions. The need for development of a specific professional skepticism scale for auditing has been stressed by several authors. The three sets of sceptical characteristics are examination of the evidence, understanding evidence-providers, and acting on the evidence. Together these determine an auditor's overall level of professional scepticism.

Some of the biggest corporate failures like Enron, WorldCom and other financial fiascos have heightened concerns that auditors are not always applying sufficient professional scepticism.

Absence of professional skeptisicm is not a local or regional issue. It is a global one. The Financial Reporting Council (FRC) has raised its concerns over insufficient auditor skepticism with the major global audit firms based on the AIU's recent and previous rounds of inspections of major audits. Other regulators like the Australian Securities & Investments Commission (ASIC) have also expressed similar concerns about whether auditors are being sufficiently skeptical in their audit of key areas of management judgment.

What does it take for an auditor to voice his or her doubts through a "questioning mind"? But what are the consequences if auditors do not voice their doubts through a "questioning mind"? I guess we all know the answer. Perhaps some of the failures I mentioned could have been avoided.

Given my coverage of independence and ancillary matters, I would now like to deal with the importance of having a single professional association here in the UAE, which caters for the need of the entire profession.

On 11 November 2010 at the United Nations Conference on Trade and Development the Deputy Chair of the Developing Nations Committee of IFAC noted that Professional Accountancy Organisations could play a key role in capacity-building by (a) acting as centres of excellence on a variety of accountancy policy issues and questions; (b) facilitating the adoption and implementation of international accounting standards; (c) educating, certifying and training professional accountants; and (d) promoting the highest ethical standards, and overseeing member compliance with the professional ethical standards.

I also recall a meeting of IFAC's Developing Nations Committee in March 2010, when the DFSA had an opportunity to present its audit supervision program. One of the issues discussed in the meeting stressed the need for a professional association recognized by IFAC.

It is encouraging to see the Big4 calling for a single professional association even though when they have access to resources. Just very recently, Mr. Warwick Hunt, the managing director for Middle East operations at PwC called for a UAE accountancy body. It is equally important for small and medium audit firms who do not have access to such resources.

I certainly appreciate and value the presence of certain international bodies like ACCA and ICAEW in the region. They both perform invaluable work. However, having a single professional association supplemented by these national and international bodies would address some of the difficulties and challenges which the profession currently faces. It would give the UAE professional one voice, promote education and qualifications.

Another area worthy on mention is audit opinion. In 2005, I referred to auditor's opinion as "impotent ". Short audit opinions, often consisting of just a few paragraphs, do not reveal the true scope of the work undertaken by auditors. Where can the users of financial reports obtain full information regarding the procedures carried out by auditors in regard to financial reporting? Should auditors be obliged to disclose more information to interested parties, and if so, in what form?

The EU Green Paper on Audit Policy calls for a high level of assurance to stakeholders from the current level of reasonable assurance.

Another aspect of auditors' opinion is extension of their mandate. It is important to consider the extent to which auditors should be assessing the forward-looking information provided by the company.

Another area is auditing of environmental and social reports. The IAASB is currently involved in developing a standard for providing assurance on carbon emissions.

Audits of large groups which operate in multiple jurisdictions are usually carried out by large global networks in view of the high level of resources such audits require. A number of audit oversight bodies around the world, including the DFSA, consider that the role of the group auditor needs to be reinforced. The group auditors should have access to the reports and other documentation of all auditors reviewing sub-entities of the group.

Finally, one way to restore confidence in audit is to have in place a universal set of standards. To this end, the International Forum of Independent Audit Regulators (IFIAR) recently issued in draft form, its "Core Principles on Audit Oversight." I am sure that Brynjar Gilberg will shed some light on these principles in his session tomorrow.

Although these core principles are not mandatory for IFIAR members, the DFSA is pleased to announce that we shall be adopting these principles in their totality as we strongly believe that these core principles will prove to be a strong foundation for effective audit supervision.

From IFIAR core principles on audit supervision, I should like to turn briefly to the DFSA's approach to audit supervision and statistics. Our Head of Special Surveillance, Matt Gamble, will be covering the statistics in details in a later session today. During 2009-2010, the DFSA conducted onsite assessments for all 16 registered audit firms. These onsite assessments covered 47 audit engagement files and 27 audit partners. This was not an easy task. Our approach to onsite supervision was purely intended to increase the audit quality of the firms involved and not to finger point the issues.

However, I do feel it appropriate to share a few instances from our first-hand experience with the firms involved. These would provide a very strong argument for my earlier points on professional skepticism.

On one particular file, we identified a significant balance which was classified as cash and cash equivalents which represented an amount transferred to a related entity which in turn was placed with a third party bank. However, although the amount was held in a bank, it was not held in a ring-fenced bank account in the name of the audit client.

Cash equivalents are defined in IAS 7 as 'short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value'. As the amount is controlled by a related entity then there is a risk that the amount is not readily convertible into cash. This had not been adequately considered and documented by the audit team.

On another audit file, no audit work had been done on the revenue that represented more than 90% of the total revenue other than obtaining a Management Representation. There was no other evidence on the working paper file. The Audit Partner had discussed this matter with the client and was satisfied with the outcome. There was no documentary evidence to substantiate this discussion.

The DFSA also noted that the initial draft audit report had a qualification which was later removed. There was no audit trail for the consideration for a clean audit opinion. Finally, the said revenue transaction which was booked in the first year was subsequently reversed in second.

We expect auditors to recognize the often complex financial transactions on which they have to opine. Auditors should obtain confirmations of critical balance sheet items. The auditors have to avoid being over-confident of their own judgments.

Auditors should certainly avoid anchoring their judgment and that of the client and should clearly investigate all current and historic data and information relating to a critical balance sheet / profit & loss item and not simply focus solely on recent data.

These are only few examples which could easily have been avoided had the firm acted with a greater professional skepticism. In my view, following ISA's is very important in improving the quality of audit.

With this, I leave you all with few points to ponder. I strongly urge you all to participate over the next day and a half with open minds. I think we can anticipate a lively and fruitful dialogue. We do not expect to find magical solutions to the problems which the profession faces in just two days but by coming together in such numbers and from all across the Gulf we can certainly make an informed start towards finding solutions.

Thank you!