



AUDIT MONITORING REPORT

2020 - 2021

Report Contents

2020 - 21 in Numbers.....	1
About this Report.....	1
Foreword.....	2
Inspection results of RAs of AFs and DFs.....	3
Quality Control Inspections Findings.....	9
Regulatory Inspections Findings.....	12
AML-Related Findings.....	15
2022 Audit Monitoring Focus.....	19



2020-21 in Numbers

17 Registered Auditors

71 Audit Principals

29 Inspections

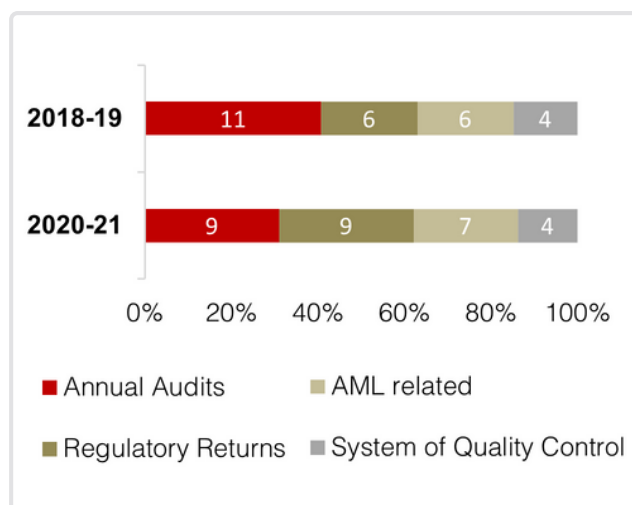


Chart 1: Types of Inspections

About this Report

This Report summarises the results of the Dubai Financial Services Authority's (DFSA) oversight visits to Registered Auditors (RAs) of Authorised Firms (AFs), Authorised Market Institutions (AMIs) and Domestic Funds (DFs) conducted over a two-year period and sets out key issues identified during 2020 and 2021.

Over the course of the review, selected audit files and audit monitoring visits may identify ways in which a particular audit file is deficient. It is not the purpose of an audit monitoring visit, however, to review all of a RAs' audits or to identify every deficiency which may exist for any particular audit. Accordingly, this Report does not provide any assurance of any audits of financial statements conducted by a RA, nor that such audits are free of other deficiencies not specifically described in this Report. This Report is not intended to be all encompassing and should not be relied upon on any basis whatsoever as any form of advice but rather are general observations. Unless stated otherwise, not all matters in this Report apply to every RA.

This Report also includes the findings from our inspections which focused on a RAs' Anti-Money Laundering (AML) obligations, System of Quality Control and a RAs' compliance with the DFSA's Auditor (AUD) Module for the purposes of issuing Regulatory Returns Auditor's Reports, Client Money Auditor's Reports, Insurance Monies Auditor's Reports, and Safe Custody Auditor's Reports (collectively referred to as Regulatory Reports). However, 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) and through separate media releases.

Reference to "instances", "occasions", "audit files" and "audit 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 firm-wide related issues.

Foreword

Welcome to the DFSA's Audit Monitoring Report for 2020-21.

During 2020-21, the Covid-19 pandemic caused significant disruption in financial markets presenting new challenges for RAs and DFSA regulated entities. These challenges included an unprecedented level of uncertainty about future earnings and the going concern status of entities.

During April 2020, the DFSA responded to these challenges by granting interim relief to Authorised Persons on certain parts of their reporting requirements. The DFSA also issued Markets Briefs to provide issuers and market practitioners with information on the DFSA's approach to disclosure obligations and certain key financial reporting considerations due to the impact of the Covid-19.

During 2020 and 2021, we increased our engagement with RAs to understand the challenges and emerging risks they faced via round table sessions and regular catchups with senior management. This allowed the DFSA to shape its regulatory approach to address the challenges faced by RAs.

Despite the disruptions posed by Covid-19 and remote working, the DFSA completed its 2020 and 2021 audit quality inspection cycles as planned. Initially, the DFSA's inspection work was largely undertaken remotely, and then gradually moved to onsite inspections towards the end of 2021. Our experience during the review period revealed that remote inspections take additional time to ensure all responses are obtained and inspection procedures completed.

In summary, the DFSA observed a decline in the number of "Satisfactory" and "Generally Acceptable" files which decreased from 95% in our last review period [2018 – 2019] to 81% in the current review period. This report analyses, in some detail, certain trends we observed during the current review period.



For the 2022 audit monitoring cycle, we issued our annual audit monitoring focus letter at the start of 2022 which includes new Quality Management Standards, amendments to the International Code of Ethics for Professional Accountants and Audit Evidence. We are doubling the size of our audit oversight team to enhance our capacity to probe further into pertinent audit quality issues.

Finally, we continue to collaborate with the local and international regulators and standard-setters through our continuous participation at the International Forum of Independent Audit Regulators (IFIAR), International Accounting Standards Board (IASB), Financial Stability Board (FSB) and Public Interest Oversight Board (PIOB).

I hope you will find this Report useful in maintaining and/or improving the audit quality.

A handwritten signature in black ink, appearing to read 'Justin Baldacchino'.

Justin Baldacchino
Managing Director - Supervision

Inspection results of RAs of AFs and DFs

Market Overview

As of 31 December 2021, the population of regulated entities that are subject to an independent audit by a DFSA RA were as follows:

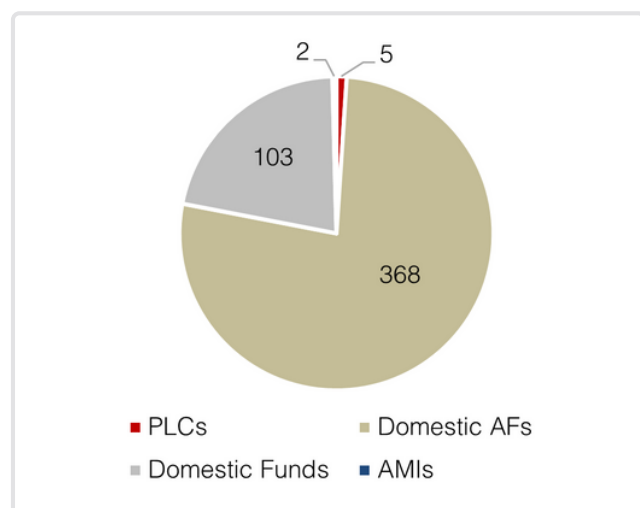


Chart 2: Regulated entities subject to an annual audit by a DFSA RA

Our file reviews covered selected compliance criteria under the relevant International Standards on Auditing (ISAs), International Financial Reporting Standards (IFRS) and the DFSA Rulebook (AUD Module).

Our file selection process also included Audit Principals (AP) yet to be inspected by the DFSA, to assess the quality of their audit work. Ten APs were assessed for the first time. These ten APs led the audits of 48% of the audit files inspected by the DFSA. The DFSA concluded that 67% of the files reviewed for these selected APs were rated "Satisfactory", 28% were rated "Generally Acceptable", and 5% rated "Improvement Required".

Our audit file reviews involved detailed discussions with the relevant AP and the auditor in-charge on the critical aspects of the audit. The DFSA's staff discussed their observations with audit teams and provided detailed written review notes setting out specific queries arising from the review. Based on the level of findings and associated responses, the DFSA assigns a grade to the audit file.

Our Reviews

The DFSA reviewed 37 engagement files in 2020-21 compared to 41 engagement files in 2018-19. The engagement files are selected after consideration of several risk factors and cover a wide spectrum of regulated entities as illustrated below:

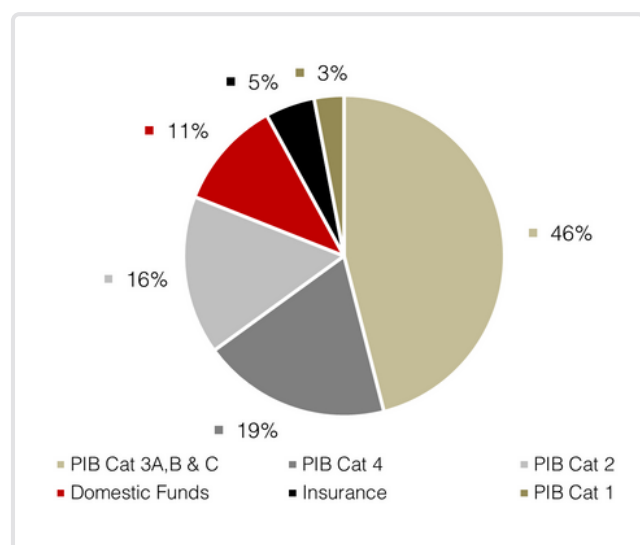


Chart 3: Percentage of files inspected by financial services category

File Grading

Of the 37 engagement files reviewed by the DFSA (41 files in 2018-19), 81% of the files were assessed as either “Satisfactory” or “Generally Acceptable”. This represents a decrease from the 2018-19 results of 95% for files in the same categories. Seven engagement files representing 19% of files reviewed were assessed as “Improvement Required”. This has increased from the 2018-19 results of 5% of files falling in the same category. It is worth noting that the audit firms and audit files we review changes each year and may impact a strict year-on-year comparison.

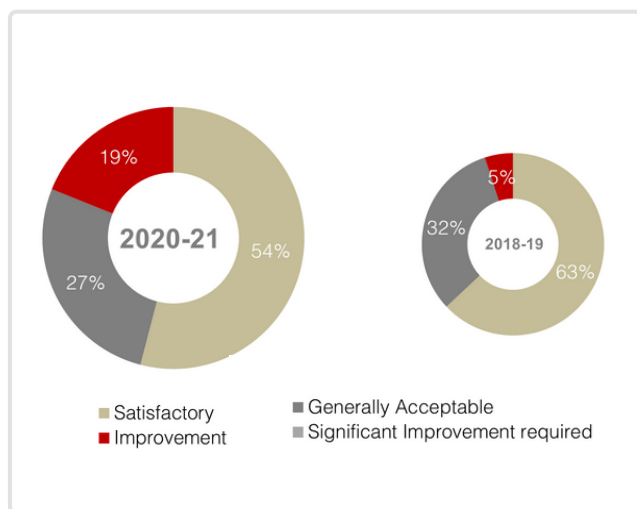


Chart 4: File grading

Trends in audit quality

Trends in audit quality should be analysed over several years to better understand what progress has been made. During its reviews the DFSA observed a decline in the quality of audit work conducted by three RAs when compared to the DFSA's previous inspection of these particular RAs. The audit work conducted on the remaining six RAs inspected continued to be of a satisfactory standard. It is also worth noting that the above referenced three RAs provide Audit Services to approximately 6% of the Domestic AF population. In addition, the DFSA prudential category of the Domestic AFs audited by these three RAs are either Category 3 or Category 4.

Commitment from RA's leadership

Reviews of audit files across RAs inspected also raised certain issues about the sufficiency and appropriateness of evidence obtained by RAs to support their conclusions on significant areas of audit. Consequently, the DFSA has taken a range of actions based on inspection results of RAs, from written observations to specific requirements for RAs to implement remedial actions and to placing APs under close supervision.

In response to our findings, the RA's senior leaderships have committed to make further changes necessary to improve audit quality. The DFSA will conduct follow up inspections to ensure RAs with unsatisfactory inspection results are taking prompt and appropriate action to address our observations and findings.

Principal Findings

The DFSA reports key matters, including significant thematic issues as Principal Findings. Principal Findings results in non-compliance with the DFSA Rulebook (AUD Module), Regulatory Law (DIFC Law No.1 of 2004 as amended), ISAs or IFRS. RAs are required to submit a plan setting out the remedial actions to be undertaken to address Principal Findings and the DFSA monitors their progress and outcomes to ensure these Principal Findings are remediated.

The DFSA raised a number of Principal Findings across the inspected RAs. These Principal Findings are divided into four themes as illustrated in the graph below:



Chart 5: Distribution of Principal Findings themes

Principal Findings Theme 1: Non-compliance with the DFSA laws and rules

We observed a few compliance failures concerning DFSA rules and regulations. These include:

a. Non-registered Audit Principal – Failure to comply with Article 97(C)(2) of the Regulatory Law DIFC Law No.1 of 2004 (Regulatory Law).

Article 97(C) prohibits an RA from permitting any person to undertake the responsibilities of an AP unless that person is registered by the DFSA as an AP. The DFSA observed an instance where the audit planning was managed by an audit partner who was not a DFSA-registered AP.

b. Auditing Prohibitions – Failure to comply with Article 97(C)(1) of the Regulatory Law.

The registered status of an RA is unique and limited to the specific entity registered by the DFSA. However, the DFSA observed an instance where an RA represented itself as a “Group of entities” in their correspondence with the DFSA and other DFSA regulated entities. The DFSA does not register auditor ‘groups’ on any basis.

The contact number and office address used in a RA’s correspondence with DFSA regulated entities and the DFSA, and the cover page of the financial statements of AFs audited by the particular RA, referred to its affiliate and not the RA itself. This indicates the affiliate is providing Audit Services to the concerned AFs without being appropriately registered as a RA.

c. Provision of timely information – Failure to comply with Article 73 of the Regulatory Law.

Article 73 vests the DFSA with power to request information and documents from RAs which the DFSA considers necessary or desirable to meet its objectives. One of the RAs inspected by the DFSA, refused to provide access to its quality review report, claiming to do so would breach the RA’s confidentiality obligations owed to its Network Firm.

d. Signing of Auditor’s Report – Failure to comply with AUD Rule 6.2.2.

AUD Rule 6.2.2 requires that every Auditor’s Report produced by an RA must include the name of the signing AP, however, the DFSA observed an instance where the Auditor’s Report did not include the name of the AP.

e. Incorrect basis for preparing financial statements – Failure to comply with GEN Rule 8.2.3 (2)(a).

AFs are required to prepare their financial statements in accordance with the IFRS. GEN Rule 8.2.3 (2)(a) allows for a specific exception whereby AFs may prepare their financial statements in accordance with IFRS for Small and Medium-Sized Entities (SMEs).

The DFSA observed an instance where an AF incorrectly prepared its financial statements in accordance with IFRS for SMEs. The RA failed to identify and notify the DFSA of this failure.

Principal Findings Theme 2: Non-compliance with ISAs

a. Fraud and other risk assessment procedures – Failure to comply with ISA 240 (Revised) - The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements.

Revenue and revenue growth are often key performance measures for DFSA regulated entities. As required by ISA 240, RAs are required to presume that there is a risk of fraud associated with revenue recognition. RAs are then required to evaluate more carefully the unique facts and circumstances applicable to each regulated entity that give rise to such risks. ISA 240 allows auditors to rebut the fraud risk presumption in revenue recognition. The below were our findings in relation to this requirement:

- For two engagement files inspected, there was no consideration of the presumed risk of material misstatements due to fraud in revenue recognition; and
- On another file, while the presumed risk of fraud associated with revenue was considered, there was no documented basis of rebutting the fraud risk presumption.

Other deficiencies observed in relation to RA's responsibilities related to fraud in an audit of financial statements included:

- No procedures designed and performed to respond to the risk of management override of controls;
- No process documentation and walkthroughs conducted for accounts associated with fraud or significant risks;
- RA's fraud checklists used to assess the regulated audited entity's fraud risk not maintained on the audit file; and
- No planning meeting discussions in relation the risk of material misstatements due to fraud.

The above findings were predominant in three of the RAs inspected. The DFSA's discussions with the relevant engagement teams revealed the reason for the above findings was due to insufficient knowledge of ISA 240 requirements. In response, the DFSA recommended that these RAs provide training on ISA 240 to the engagement teams to reduce findings in this area.

The DFSA also identified certain other findings concerning the risk assessment procedures conducted by the RAs:

- For one engagement file, the engagement team failed to document relevant assertions and risk of material misstatement for each relevant assertion. As a result, the audit procedures conducted were not linked to any relevant assertions and the associated risk of material misstatements; and
- On another engagement file, the engagement team planned to rely on controls for selected account balances, however, there was no evidence of those controls being tested.

b. Evidence of AP Involvement – Failure to comply with ISA 220 – Quality Control for an Audit of Financial Statements and ISA 230 – Audit Documentation.

ISA 220 requires APs to be involved at appropriate stages during the engagement to allow significant matters to be resolved on a timely basis. On a number of files reviewed, the DFSA observed that APs signed off key planning documents on or near the date of signing of the Auditor's Report. In some instances, the audit documentation did not evidence the AP's attendance at engagement team planning meetings. In one instance, there was no evidence of the AP's involvement in developing the overall audit strategy.

ISA 230 also requires APs to document the extent and timing of their involvement in the review of the audit file. However, on a number of engagement files, there was no evidence of review by the AP of key sections of the audit.

c. External Confirmation Process – Failure to comply with ISA 505 – External Confirmations.

External confirmation procedures generally provide strong audit evidence to RAs. ISA 505 sets out specific requirements which RAs should adhere to when using external confirmations as a source of audit evidence. Deficiencies noted in the external confirmation process include:

- In one instance, the DFSA observed the confirmation requests were sent by the AF and not by the engagement team. This results in a lack of control during the confirmation process as required by ISA 505. It was surprising to note this finding, as the DFSA has raised this issue on numerous occasions during its annual outreach sessions;
- On one file, the AF held gold investments with a third-party. The value of this investment exceeded the audit materiality threshold, however, the engagement team did not obtain independent third-party confirmation of the quantity of gold investments held by the AF at year end. Given the high-risk nature of the asset and its potential exposure to fraud, the engagement team should have independently confirmed the existence of the gold at the year end;
- On another file, the engagement team failed to obtain independent bank confirmation for a fixed deposit balance held by a related party, specifically a commercial bank. The engagement team instead verified the fixed deposit balance on the AF's internal banking system. The engagement team failed to assess whether the evidence obtained from an internal system was reliable; and
- In one instance, the engagement team did not receive a response to a bank confirmation for material bank balance. The team conducted an alternative procedure of relying on a bank statement and deposit slip supplied by the AF, however, the engagement team failed to assess whether the evidence obtained via the alternative procedure was sufficient and appropriate. The alternative procedure for instance, provided no evidence on whether the bank balance was free of any encumbrances.

d. Use of expert/specialist – Failure to comply with ISA 620 – Using the Work of an Auditor's Expert.

ISA 620 requires the RA to evaluate the adequacy of its internal expert's work for the audit purposes.

On one file inspected, the engagement team involved the RA's internal valuation experts in the valuation of an investment property owned by the AF, however, there was no copy of the internal valuation report from the valuation expert on file. Further there were no documented minutes of meetings held between the engagement team and the internal valuation team to discuss the valuation team's work.

In another instance, there was no evidence of work done by the engagement team (such as reviewing the source data, methods, assumptions applied by the auditor's expert) to evaluate the adequacy of the RA's internal valuer's report. Further, there were no details of the valuer's underlying calculations conducted to arrive at the value of the investment property.

Principal Findings Theme 3: Non-compliance with the International Ethics Standards Board for Accountants (IESBA) Code of Ethics for Professional Accountants (Code)

a. Provision of Internal Audit Services – Non-compliance of IESBA Code

An affiliate of an RA was in discussions with the management of one of the RA's audit clients to provide internal audit services. The RA's audit client was an AF.

The provision of external and internal audit services by an RA and its affiliate raises concerns of a perceived conflicts of interest under Article 99A(2)(a) of the Regulatory Law. Further, the IESBA Code precludes an RA from assuming any management responsibility of an audit client. The IESBA Code provides examples of internal audit services that involve assuming management responsibilities. The RA failed to consider these examples or conduct any due diligence on the scope of the internal audit service to be provided by its affiliate to determine whether the affiliate was assuming any management responsibilities for the audit client.

Principal Findings Theme 4: Non-compliance with IFRS

a. Recognition of contingent assets – Non-compliance of IAS 37 - Provisions, Contingent Liabilities and Contingent Assets

IAS 37 states that contingent assets should not be recognised but should be disclosed where an inflow of economic benefits is probable.

For one file inspected, the AF had recognised a related party receivable which represented 44% of the total assets of the AF. That receivable related to costs incurred on behalf of a fund yet to be launched by the AF. The AF expected to recover those costs from future investors in the fund. Given that there was no written agreement in place with prospective investors, we do not consider the recoverability of the balance as virtually certain. Moreover, the recoverability of those costs was contingent on finding prospective investors.

The engagement team failed to exercise professional scepticism in the audit for this related party receivable balance as there was no questioning of the basis for recognition of this balance.

Quality Control Inspections Findings

To provide a holistic view of audit quality within RAs, the DFSA conducts firm-wide inspections for selected RAs to assess the RA's system of quality control. The DFSA requires RAs to comply with the International Standard on Quality Control (ISQC1), as issued by the International Auditing and Assurance Standards Board (IAASB). ISQC1 requires RAs to establish appropriate policies and procedures to ensure quality audit engagements.

While the System of Quality Control continues to operate effectively, the DFSA highlighted certain improvement opportunities which were mostly self-identified by the RAs during their internal quality reviews.

The DFSA also assessed RAs implementation plans for the International Standards on Quality Management (ISQM). RAs are required to have their system of quality management designed and implemented by December 15, 2022. The DFSA observed that RAs are at different stages of implementing the new standards and urges RAs to take immediate action to ensure the standards are implemented by the required date.

ISQC1 requires RAs to establish policies and procedures designed to promote an internal culture which recognises that quality is essential in performing audit engagements. A key part of the DFSA's ISQC 1 inspections was to assess how RAs link audit quality and partners' performance evaluation, promotions, and compensation. The DFSA also evaluated RAs policies and procedures across the following areas:

- Partner appraisals and remuneration;
- Promotions;
- Recruitment;
- Portfolio and resource management;
- Audit quality monitoring;
- Consultation policies; and
- Root cause analysis.

Below are certain key findings and good practices we identified during the firm-wide inspections:

a. Partner appraisals and remuneration

It was encouraging to note that some partner appraisal forms we reviewed, incorporated clear consideration of audit quality. In some RAs, appraisal forms for APs included commentaries on the results of internal and external inspections during the year.

b. Internal Quality Reviews

Certain RAs have deployed dedicated internal teams who are responsible for identifying audits and conducting reviews on a real-time basis. These teams serve as second line of defence where reviewers coach engagement teams throughout the audit cycle. Issues observed during these reviews are communicated to engagement teams and duly addressed before signing-off the audit opinions.

RAs have also taken measures to improve internal audit quality monitoring processes, often involving international reviewers from their network.

c. Consultation

Certain RAs conducted benchmarking exercises to determine the sufficiency and quality of resources in technical consultation teams. The objective of the benchmarking exercise was to assess whether the RAs have:

- sufficient human resources of appropriate seniority; and
- sufficient experience and depth of technical expertise to carry out consultations, informal queries, and other activities with respect to IFRS, local financial reporting standards (as applicable) and ISAs.



For RAs that had not conducted such benchmarking exercises, we recommended benchmarking assessments to be conducted and results of the assessment reported to the DFSA.

d. Working Papers Archive

Certain RAs inspected by the DFSA have instituted firm-wide policies of shorter archival time. In some instances, RAs have mandated a shorter timeframe than the 60 days as required by ISQC 1 and ISA 230.

The DFSA observed that certain RAs use audit software to trigger automated reminders to engagement teams of impending archival due dates and the use of central monitoring mechanisms to allow more frequent reviews on archival statistics to prevent and detect late archival.

The RAs inspected by the DFSA had also instituted full paperless processes by mandating the use of the RA's audit software to house all audit evidence.

e. Root Cause Analysis (RCA)

The DFSA observed that the RAs inspected had well developed RCA processes with certain elements of good practice including focus group sessions, involvement of behavioural specialists, and use of dedicated RCA teams etc.

RAs should consider recommendations arising from the DFSA's findings, to further enhance their efforts to raise audit quality standards.

RAs are encouraged to perform analysis of Audit Quality indicators (AQIs) as part of their RCA process. This will help identify any correlations between AQIs and Inspection results. For example, where strong correlations are identified, it will enable RAs to intervene before an audit is complete where those AQIs are monitored during the audit.

f. Portfolio and resource management

Audit partners working higher hours, managing larger numbers of clients, and/or higher risk engagements, may be at risk for quality lapses. The DFSA monitors partner portfolio reviews as part of its firmwide ISQC1 inspections. In one of the RAs inspected, the DFSA observed a substantial improvement in partner portfolio hours over the last three years. However, the average partner portfolio hours were still above the RA's global network average. It was encouraging to see that the RA had put in place a two-year plan to reduce the partner portfolio hours to the RA's global network target.

For three of the RAs inspected, there were no formal global and regional policies restricting partner portfolio hours. For these RAs, the DFSA recommends benchmarking exercises be conducted to consider the appropriateness of portfolio hours at the local level. The DFSA will be closely monitoring the portfolio sizes of APs which will now be reported annually by selected RAs to the DFSA. Where significant deviations are noted, the DFSA will follow up with RAs on action plans to actively reduce / manage the portfolio hours of APs. RAs should improve the robustness of the processes for centralised review and monitoring of partner portfolios, including to ensure that deadlines are scheduled to enable APs and engagement teams sufficient time to spend on each engagement.

g. Ethics-related complaints

For three of the RAs inspected, the DFSA was not convinced that the RA's website made it easy for its clients or external contractors to report ethics-related issues in a convenient manner. Further, for one RA, there was no specific reference to the ethics portal in either the RA's Standard Terms of Business or Engagement Letters. While it is not a requirement under the DFSA Rules, we encourage RAs to improve visibility of systems and controls for ethics-related submissions in the terms of business and engagement letters and for third parties on its website.

h. Diversity and Inclusion

The DFSA also assessed the diversity and inclusion of RAs leadership teams and boards during the conduct of its ISQC 1 inspections. The DFSA is of the view that creating diverse teams fosters an inclusive work environment and helps to develop more relevant insights. Diversity and inclusion are especially important in audit where professional scepticism, challenge and critical thinking form the bedrock. The DFSA notes that RAs are making concerted efforts to build strong, diverse, and inclusive teams, however, we believe room for improvement remains at the leadership and board levels. During inspections, the DFSA observed that gender diversity is now embedded as a key metric across the RAs inspected with some RAs required to report on an annual basis on progress made in this area. Gender diversity is factored into RAs succession planning to ensure the pool of qualified and experienced women is widened. The DFSA will continue to monitor progress made on an annual basis and encourages leadership to make gender balance a priority at the RA leadership and board levels.



Regulatory Inspections Findings

The DFSA performs periodic inspections to assess RAs’ compliance with AUD Rules for the purposes of issuing Regulatory Reports. Below is a graph of the types of Regulatory Reports inspected over the review period:

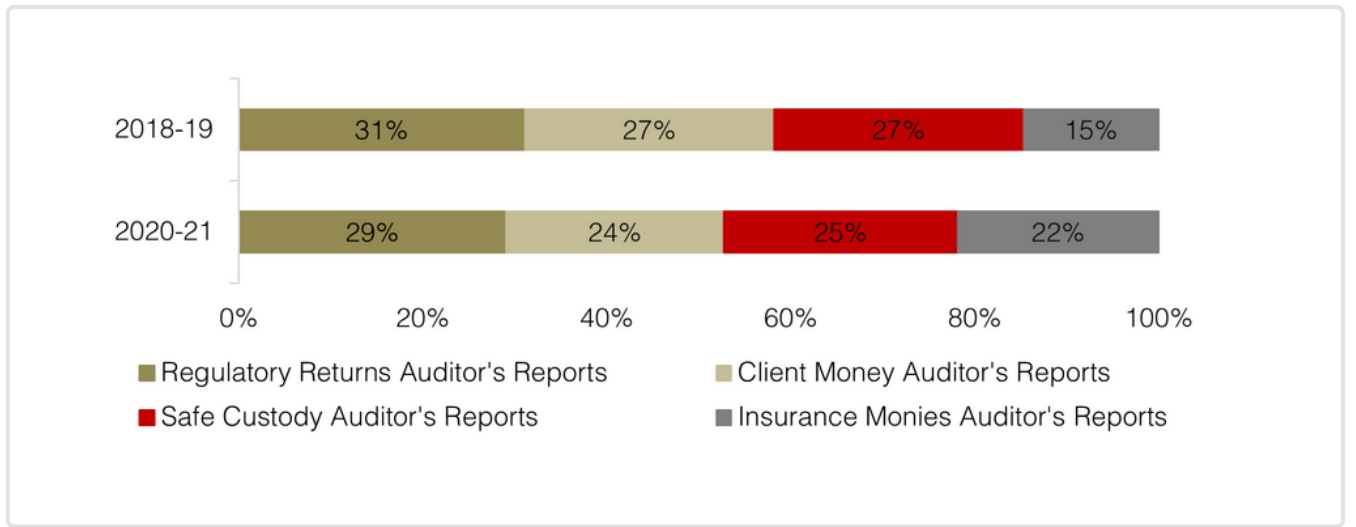


Chart 6: Distribution of reviewed engagement files by the report type

Regulatory Returns Auditor’s Report

The work on Regulatory Returns Auditor’s Reports was of satisfactory standard except for the below Principal Findings:

Capital Resources

- For six Regulatory Returns Auditor's Reports inspected, there was no testing to ensure that the AFs maintained, at all times, capital resources calculated in accordance with the PIB rules.

This remains a concern for the DFSA. RAs must test the adequacy of capital resources at random dates to ensure AFs have always maintained appropriate capital.

Signing Audit Principal

- On one Regulatory Returns Auditor’s Report, the name of the signing AP was not included. AUD 6.2.2 requires RAs to ensure that every audit report produced by it includes the name of the AP.

Safe Custody Auditor's Report

Safe Custody Auditor's Reports require some improvements, as we identified the below Principal Finding in relation to one Safe Custody audit conducted:

a. Lack of Systems and Controls

The DFSA Rules require that the RA report on whether an AF has adequate systems and controls to enable it to comply with applicable Safe Custody provisions in COB App6 throughout the year.

These systems and controls take various forms including performing suitability assessments of Third-Party Agents (TPAs), establishing a separate Client Assets Account, and seeking acknowledgement from the TPA regarding segregation of AF's own assets versus Client Investments.

Principal Finding

On one engagement file, there was no evidence of systems and controls testing being conducted. However, the Safe Custody Auditor's Reports indicated that the AFs had maintained adequate systems and controls throughout the year.



Client Money Auditor's Report

Client Money Auditor's Reports require some improvements, as we identified a number of issues.

a. Lack of Systems and Controls

The DFSA Rules require that RAs report on whether an AF has adequate systems and controls to enable it to comply with applicable Client Money provisions throughout the year.

These systems and controls take various forms including:

- performing suitability assessment of TPAs;
- establishing a separate Client Money Account; and
- seeking acknowledgement from the TPA regarding segregation of AF's own funds versus client funds; etc.

The DFSA observed the below deficiencies in relation to the systems and controls testing:

Principal Findings

- On one file, the RA failed to disclose the AF's non-compliance with the requirement to obtain confirmation from a TPA within a reasonable period that it will not co-mingle the AF's money with the Client Money; and
- Three AFs failed to set up a segregated Client Money Bank Account as required by the COB Rules. The RAs failed to include this issue in the AF's Client Money Auditor's Report. Instead, the RAs sought to rely on the non-existence of Client Money as a basis for determining a segregated Client Money bank account is not required. However, DFSA Rules require the AF to have adequate systems and controls in place at all times.

b. Lack of understanding of Client Assets rules

On one file, the engagement team concluded that the AF was not controlling Client Money. The team advised that, although the AF has a mandate to invest and reinvest investor monies contributed to a fund, the AF must still abide by direction of the Board of Directors and the terms of the Memorandum and the Articles of the Fund.

However, since the AF (as the responsible legal person) holds a mandate to manage the investment and reinvestment of investor monies contributed to the fund and related earnings, the AF does, in fact, have control of the monies and earnings. Accordingly, the Client Money Auditor's Report should therefore reflect this.

Insurance Monies Auditor's Reports

The work on Insurance Monies Auditor's Reports requires some improvements. The DFSA has one Principal Finding:

- For one file inspected, the AF did not obtain a written confirmation from an Eligible Bank confirming that it was not entitled to combine the Insurance Bank Account (IBA) with any other account as mandated by DFSA Rules. The RA failed to include this issue in the Insurance Monies Auditor's Report.

AML-Related Findings

The DFSA's AML Module applies to all RAs and responsibility for compliance with the AML Rules lies with every member of the RA's senior management. The DFSA strongly recommends RA's senior management familiarise themselves with the RA's obligations under the AML Rules.

The Money Laundering Reporting Officer (MLRO) is responsible for the day-to-day operations for compliance by the RA with its AML policies, procedures, systems and controls.

a. Registration on the UAE Financial Intelligence Unit's (FIU's) GoAML Platform

All RAs are required to register on the FIU's GoAML platform for the purposes of making suspicious activities reports under AML Rule 13.3.1(c) and applicable Federal AML legislation.

The DFSA, in its capacity as sole administrator of AML/CFT and Sanctions Compliance regulation in the DIFC, is the Supervisory Body for accepting both the pre-registration and GoAML registration submissions for all Relevant Persons including RAs.

The DFSA performed seven AML risk assessments of RAs and observed that all RAs inspected had successfully registered on the GoAML platform at the time of the inspections. The DFSA continues to monitor the registration process on a quarterly basis. For the reporting period, the DFSA notes that all RAs confirmed full completion of the GoAML platform registration process.

The DFSA identified certain good AML practice points from our AML inspections including:

- tailored Business AML Risk Assessments (BARA) and obtaining buy-in from all areas of the RAs business including senior management and heads of the different service lines within the RA;
- acknowledgement and sign off on AML systems and controls by senior management to evidence oversight and responsibility for the RA's AML compliance; and
- most RAs displayed a good grasp of the factors that should be taken into consideration when assessing the specific AML risks posed by customers.

The DFSA also identified certain deficiencies in RAs' AML systems and controls for which the DFSA has taken appropriate steps including, issuing specific risk-mitigation plans to be implemented by RAs and performing follow-ups to ensure that these risk-mitigation plans are properly implemented. Key findings are as detailed below.

b. Assessing Business AML Risks

AML Rule 5.1.1 requires RAs to undertake a BARA to identify and assess money laundering risks to which the RA's business is exposed to.

DFSA Rule	Our Findings
AML Rule 5.1.1	<p>The DFSA reviewed the BARA of the RA's inspected and identified the following issues with two of the RA's BARA:</p> <ul style="list-style-type: none">• the BARA did not consider the UAE National Risk Assessment (NRA), which has assessed Auditors as "medium" risk for AML purposes;• there was no differentiation between inherent and residual AML risks; and• there was a lack of documentation on mitigating systems and controls to reduce identified AML risks from "medium" risk as per the NRA to "low risk" as per the BARA.

c. Systems and Controls

AML Rule 5.2.1 requires RAs to maintain effective policies and procedures, systems, and controls to prevent opportunities for money laundering.

DFSA Rule	Our Findings
AML Rule 5.2.1	<p>Our review of the AML systems and controls policy manuals of RAs identified the following deficiencies:</p> <ul style="list-style-type: none">• for one of the RAs inspected, the systems and controls outlined in the RA's AML manual did not reflect the AML procedures operating in practice. For example, the AML manual referred to "Client Take on Procedures Form" and "KYC Form" which were not being used by the RA;• for another RA, the Suspicious Activity Reporting (SAR) process noted in its AML manual was outdated and not in line with the current SAR process;• the AML manual of one RA was missing relevant reference information, including Federal Law references as stated in the DFSA AML Module; and• AML manuals of two RAs contained erroneous information, including incorrect exceptions to customer identification requirements and incorrect DFSA Rulebook references.

d. Assessing Customer AML Risks

AML Rule 6.1.1 requires RAs to undertake a risk-based assessment of each customer and assign each customer a risk rating proportionate to their money laundering risk.

DFSA Rule	Our Findings
AML Rule 6.1.1	<p>The DFSA identified the following deficiencies concerning this rule:</p> <ul style="list-style-type: none">• RAs on some occasions did not take reasonable steps to determine if a customer or Ultimate Beneficial Owner (UBO) was a Politically Exposed Person (PEP);• in a few instances, the customers business activity and jurisdiction were not taken into consideration when determining AML risk scores; and• for one RA, there was no rationale or methodology for the calculation and assignment of the AML risk score.

e. Customer Due Diligence (CDD) Requirements

AML Rule 7.1.1(1)(a) requires RAs to undertake CDD on each of its customers. In undertaking CDD, RAs must identify and verify the identity of the customer and any beneficial owner. Further, when undertaking Enhanced CDD, RAs must understand and verify the customers source of funds and source of wealth in accordance with the AML Rules.

DFSA Rule	Our Findings
AML Rule 7.1.1(1)(a)	<p>In relation to these requirements, the DFSA identified the following:</p> <ul style="list-style-type: none">• in undertaking CDD, we identified instances where the RAs did not verify the identity of the UBO;• in some instances, beneficial ownership of corporate entities was not established and verified, particularly where there were levels of ownership; and• in one instance, the RA was not able to demonstrate that the UBOs of corporate entities and related parties were subject to sanctions screening or considered to be PEPs.

f. Other enhanced measures: PEPs

AML Rule 7.3.8(1)(a) requires RAs to take reasonable measures to determine if a customer or a beneficial owner of a customer is a PEP. AML Rule 7.3.8(2) details additional due diligence required where a customer or UBO is a PEP.

DFSA Rule	Our Findings
AML Rule 7.3.8(1)(a) AML Rule 7.3.8(2)	The DFSA observed the following: <ul style="list-style-type: none">instances where RAs failed to obtain senior management approval to onboard clients with a PEP as a UBO/shareholder; andon certain files, there was no evidence of the RA establishing and verifying the source of wealth and source of funds for PEPs.

g. Enhanced Due Diligence (EDD)

AML Rule 7.4.1 requires RAs to undertake EDD measures for customers assigned a high AML risk score.

DFSA Rule	Our Findings
AML Rule 7.4.1	The DFSA observed a number of instances where EDD measures such as, (i) establishing source of funds and source of wealth of the customer or UBOs, and (ii) obtaining senior management approval to commence the business relationship, were not undertaken.

h. Ongoing Due Diligence

AML Rule 7.3.1(d) requires an RA to conduct on-going diligence of its customer base. The steps required to conduct this risk based on-going due diligence are set out in AML Section 7.6.

DFSA Rule	Our Findings
AML Rule 7.3.1(d) AML Section 7.6	The deficiencies identified by the DFSA included: <ul style="list-style-type: none">outdated or missing documents and information on customer AML files;a lack of evidence of ongoing sanctions screening;AML manuals of RAs not clearly defining the requirements and process of undertaking ongoing due diligence;ongoing CDD driven by contract renewal date or annually rather than a risk-based approach;some RAs applied a blanket approach to ongoing CDD for all customers with no distinction between ongoing CDD requirements for high, medium and low AML risk customers; andsome AML manuals reviewed did not contain specific guidance on how regularly CDD information should be reviewed.

i. Sanctions and Other Obligations

The guidance to AML Rule 10.2.1 notes that Relevant Persons should be aware of their obligations under Federal Cabinet Decision No. 20 of 2019 concerning the UAE list of persons and terrorist organisations and United Nations Security Council (UNSC) Resolutions regarding the Suppression and Combating of Terrorism, Terrorist Financing and Proliferation of Weapons of Mass Destruction, and Related Resolutions.

DFSA Rule	Our Findings
AML Rule 10.2.1	<ul style="list-style-type: none">• As noted above, all RAs inspected during the reporting period had registered on the FIU's GoAML platform for the purposes of making suspicious activities reports;• the DFSA observed instances where RAs failed to check on a daily basis, the sanctions lists issued by the UNSC;• it is worth highlighting the business model of RAs within the DIFC, which is, RAs commence their relationship with the audit client at the signing of an engagement letter and conclude that relationship at the signing of the deliverable (the Auditor's Report). The RA does not usually maintain a relationship with the audit client outside this period. The RA recommences a new relationship with the client at the signing of the engagement letter for the next year's audit;• as a result of the above, the RAs inspected advised the DFSA that they conduct sanctions screening only at critical stages during the client relationship, such as the time of signing the audit engagement letters, before issuing the auditor's reports, and annually for each audit acceptance; and• notwithstanding the above business model, the DFSA observed that all RAs inspected have subsequently implemented ongoing sanctions screening tools to comply with their obligations under Cabinet Decision No. 20 of 2019.

j. Record Keeping

AML Rule 14.4.1 requires RAs to maintain AML records for at least six years from the date on which a notification or report is made, the business relationship ends, or a transaction is completed, whichever occurs last.

DFSA Rule	Our Findings
AML Section 14.4	The DFSA identified instances where required AML records/documentation (i.e., Certificate of Incorporation, Articles of Association, control and ownership structure, initial sanctions screening, principal place of business) were not on the AML files of customers.

2022 Audit Monitoring Focus

The DFSA's audit inspection cycle runs from January to December each year. The DFSA's 2022 audit monitoring focus (communicated to RAs at the start of the inspection cycle) includes, but not limited to, the following:

1. New Standards on Quality Management.
2. Amendments to the International Code of Ethics for Professional Accountants (the Code).
3. Audit Evidence.

These focus areas are elaborated on below.

New Standards on Quality Management

The IAASB has issued new and revised standards to strengthen and modernise how RAs approach quality management (the New QM Standards). Through these New QM Standards, the IAASB is seeking to address an evolving and increasingly complex audit ecosystem, including growing stakeholder expectations and a need for quality management systems that are proactive and adaptable.

The New QM Standards direct RAs to improve the robustness of their monitoring and remediation, embed quality into their corporate culture and the "tone at the top", and improve the robustness of engagement quality reviews.

The complete suite of New QM Standards will come into effect on 15 December 2022, and include the following:

- ISQM 1 – Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements;
- ISQM 2 – Engagement Quality Reviews; and
- ISA 220 (Revised) – Quality Control for an Audit of Financial Statements.

The New QM Standards will apply to all RAs that conduct financial statement audits or provide other assurance related engagements. Under the New QM Standards, RAs are required to design a system of quality management to manage the quality of audit engagements they perform. This also requires RAs to demonstrate a commitment to quality through the culture which exists throughout the firm.

The IAASB has issued a first-time implementation guide for the New QM Standards which can be accessed below:

<https://www.iaasb.org/publications/isqm-1-first-time-implementation-guide>

<https://www.iaasb.org/publications/isqm-2-first-time-implementation-guide>

The DFSA will look for evidence that RAs have considered the requirements of the New QM Standards and have made sufficient preparation for their timely implementation on or before the 15 December 2022.

Amendments to the Code

The IESBA issued revisions to the Code in April 2021. These revisions included changes to the Non-Assurance Services (NAS) and fee-related provisions of the Code and are effective 15 December 2022.

Changes were made to NAS to address circumstances in which a firm or network firm could provide NAS to audit or assurance clients.

One of the more significant changes relates to the provision of accounting and bookkeeping services. The revised Code makes clear that the provision of these services creates a self-review threat when the results of the services affect the accounting records on which the firm will express an opinion.

Fee-related provisions of the Code include:

- a prohibition on allowing the audit fee to be influenced by the provision of NAS; and
- guidance to identify, evaluate and address threats to independence from other fee-related matters, including the provision of fees for NAS.

The DFSA's audit monitoring visits will include consideration of how the RAs have addressed the revisions to the Code as they relate to NAS and fee-related provisions.

Audit Evidence

Covid-19 has presented RAs with challenges in obtaining audit evidence. However, it has not changed the requirements around the nature or extent of audit evidence required to support audit opinions.

The consequences of Covid-19 often requires RAs to use audit procedures, including remote working and technology to obtain audit evidence. Covid-19 has also changed the extent and nature of risks that RAs should consider when determining audit procedures to be performed and when obtaining audit evidence.

During the upcoming inspection cycle, the DFSA will consider how RAs have addressed challenges in obtaining audit evidence resultant from Covid-19. The DFSA will look for evidence confirming that RAs have considered the impact of Covid-19 on material areas of the audit, such as going concern, the impairment of tangible and intangible assets, valuation of non-current assets, such as property, and expected credit losses for receivables.

Other Focus Areas

During 2022, the DFSA will continue to undertake onsite visits of selected RAs in relation to their reporting of DFSA regulated entities in accordance with AUD Rule 6.2.1. The DFSA will continue to assess engagement teams, their competencies and the level of training provided by RAs to their respective personnel to enable those personnel to perform work on all relevant regulatory reports:

1. Regulatory Returns Auditor's Report;
2. Client Money Auditor's Report;
3. Insurance Monies Auditor's Report;
4. Safe Custody Auditor's Report; and
5. Money Services Auditor's Report.

Where relevant, the DFSA will also evaluate the work of group engagement partners on group audits, and the work of Audit Principals where the work is performed by another entity of the RA.





FOR GENERAL ENQUIRIES

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