



CONSULTATION PAPER NO. 91

16 DECEMBER 2013

PROPOSED ENHANCEMENTS TO THE AUDITOR REGIME

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PROPOSED CHANGES TO THE AUDITOR REGIME

Why are we issuing this paper?

1. The DFSA proposes to enhance its current regulatory regime applicable to auditors of Authorised Firms, Authorised Market Institutions, Public Listed Companies and Domestic Funds. This paper sets out those proposals for public consultation.
2. The proposals in this paper are designed to:
 - (a) refine the current auditor regime based on operational experience gained over the past five years; and
 - (b) align the auditor regime with international best practice.

Background

3. The DFSA is already responsible for the registration and oversight of auditors in respect only of Authorised Firms, Authorised Market Institutions, Public Limited Companies and Domestic Funds. While it is not a common arrangement for a financial services regulator also to carry out auditor regulation, the unique nature of the DIFC as a jurisdiction, including the absence of a professional audit body to carry out a regulatory role within the DIFC, means that it was prudent for the DFSA to take on this limited role; this remains the case.
4. This review primarily focuses on assurance services provided by auditors which are performing a review of a client's financial statements, compliance with relevant DFSA requirements, and providing an audit opinion/report on these items.
5. Non-assurance activities were considered in the review to the extent that provision of those services would create a conflict of interests when assurance services are also being provided (see paragraph 29). Non-assurance services include, for example, the preparation of accounting records and financial statements, valuation services, taxation services and internal audit services.
6. With over five years of active operational experience of the auditor regime, the review provided an opportunity to address common issues arising from on-site assessments.¹ In keeping with our continued efforts to maintain a regulatory regime in line with international standards, alignment has also been pursued with regard to the International Forum of Independent Audit Regulators (IFIAR) principles and relevant elements of the standards of the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS). Benchmarking was also conducted against the auditor regimes in leading jurisdictions (e.g. the United Kingdom, Canada, Australia, Singapore) to ensure that our regime keeps pace with best practice.
7. In proposing amendments to the regulatory regime for auditors, the DFSA has been mindful to take a risk-based stance, in keeping with our regulatory

¹ On 5 May 2013, the DFSA published an [Audit Monitoring Report](#) on the first five years of operation of the auditor regime.

approach. Where possible, efforts have also been made to improve the ease of use of the Rulebook. In particular, a dedicated Module for Auditors (AUD – see Appendix 1) is proposed, which contains relevant Rulebook provisions.

Who should read this paper?

8. The proposals in this paper would be of particular interest to:
- (a) Authorised Firms (AFs);
 - (b) Authorised Market Institutions (AMIs);
 - (c) Domestic Funds (DFs);
 - (d) Public Listed Companies (PLCs);
 - (e) auditors of AFs, AMIs,² PLCs and DFs;
 - (f) applicants for registration as a Registered Auditor with the DFSA;
 - (g) Audit Principals; and
 - (h) regional audit regulators.

Terminology in this paper

9. In this paper, defined terms are identified throughout by the capitalisation of the initial letter of a word or of each word in a phrase and are defined in the Glossary Module (GLO) or in the proposed amendments in this paper. Unless the context otherwise requires, where capitalisation of the initial letter is not used, the expression has its natural meaning.
10. 'Auditors' refers to auditors that provide audit services to Domestic Funds, PLCs, AFs and AMIs.¹ In contrast, 'Registered Auditors', refers to a subset of Auditors which provide audit services to (i) AFs and AMIs that are Domestic Firms, (ii) Domestic Funds, and/or (iii) PLCs. That is, Registered Auditors excludes those Auditors that only provide audit services to Branches.

How to provide comments?

11. All comments should be in writing and emailed to the address specified below. Please refer to the Consultation Paper number in the subject line. You may, if relevant, identify the organisation you represent in providing your comments. The DFSA reserves the right to publish, including on its website, any comments you provide, unless you expressly request otherwise at the time of making comments.

Comments to be addressed or emailed to:

**Consultation Paper No. 91
Policy and Legal Services
DFSA
PO Box 75850
Dubai, UAE**

Email: consultation@dfsa.ae

Tel: +971(0)4 3621500

² Whether the AF or AMI is a Domestic Firm or Branch.

What happens next?

12. The deadline for providing comments on the proposals is **14 February 2014**. Once we receive your comments, we shall consider if any further refinements are required to these proposals. We may then proceed to recommend the proposed changes to the Regulatory Law 2004 (Regulatory Law) and the Collective Investment Law 2010 (CI Law) to the President for enactment by the Ruler. If the proposed changes to the Regulatory Law and the CI Law are enacted, we shall then proceed to enact the relevant changes to the DFSA's Rulebook. You should not act on these proposals until the relevant changes to the Regulatory Law, CI Law and DFSA Rulebook are made. We shall issue a notice on our website telling you when this happens.

Key Proposed Changes in the Auditor Regime

13. The most significant proposed amendments to the DFSA's auditor regime are found below. Requirements applying to Auditors are grouped in Parts 1 to 4. Requirements applicable to AFs, AMIs, PLCs and DFs are contained in Part 5. Where transitional arrangements are proposed, they are noted in the relevant section.

Part 1: Audit Principals

Part 2: Auditor Independence

Part 3: Miscellaneous requirements for Auditors

Part 4: Auditor Fees

Part 5: Requirements applicable to AFs, AMIs, PLCs and DFs.

Part 1: Audit Principals

Registration of Audit Principals

14. The DFSA proposes to introduce a requirement to register Audit Principals of Registered Auditors (see AUD section 2.4 and the proposed Regulatory Law Articles 100(2) and 101 in Appendix 2). This arrangement is common in leading jurisdictions, and is usually undertaken by a professional body. In the absence of such a body to carry out this role in the DIFC, the DFSA proposes to take on this role.
15. The responsibilities of an Audit Principal will not change under the proposals although, importantly, their personal accountability will increase, as the DFSA will have powers to intervene directly with the Audit Principal (rather than indirectly via the Registered Auditor). An Audit Principal will continue to be defined as the individual responsible for managing the conduct of the audit work undertaken by a Registered Auditor and signing audit reports, or any other reports as may be required under the Rules on behalf of the Registered Auditor (see the proposed Regulatory Law Article 97).
16. Currently, it is a Registered Auditor's responsibility to ensure that each Audit Principal is fit and proper to conduct audit work on behalf of the Auditor. However, in practical terms, when assessing an applicant for registration as an Auditor the DFSA will also consider the fitness and propriety of Audit Principals. As the proposal formalises the current DFSA process it is not considered to impose a significant new burden. Additionally, no fees will be charged to register Audit Principals. Approved Audit Principals will be published in a public register maintained by the DFSA.
17. The DFSA is seeking to set out explicitly the Principles which Audit Principals are required to uphold (see AUD section 2.6). Currently, Registered Auditors are required to comply with the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants (IESBA Code). The Principles we propose to introduce are based on those of the IESBA Code and are as follows:
 - (a) Integrity;
 - (b) Objectivity;
 - (c) Professional competence and due care;
 - (d) Confidentiality; and
 - (e) Relations with the DFSA.
18. The proposed principle regarding 'Relations with the DFSA' requires Audit Principals to be open and cooperative with the DFSA and to disclose to the DFSA any information of which the DFSA would reasonably expect to be notified.
19. The application of these principles (excluding 'Relations with the DFSA') is common across benchmarked jurisdictions. It is important to note that the IESBA Code principles apply to Audit Principals in all their activities, and not solely to those activities that are relevant to firms regulated by the DFSA.

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20. In terms of transitional arrangements, existing Audit Principals are proposed to be automatically registered as an Audit Principal when (subject to paragraph 12) the new auditor regime comes into effect. Audit Principals would then have 60 days to submit a notification to the DFSA confirming their intention to continue to undertake the responsibilities of an Audit Principal under the proposed new regime, in addition to providing details that would, in the future, normally be required for registration of an Audit Principal (see AUD section 2.7). A form will be made available in due course.

Issue for consideration

1. Are there any objections to the proposed introduction of the registration of Audit Principals? If so, what are they?

Criteria for Audit Principals

21. The criteria used to assess whether an Audit Principal is fit and proper under the existing regime are proposed to be incorporated in the criteria for registration as an Audit Principal. To register as an Audit Principal, an individual must hold a Recognised Professional Qualification, be a member in good standing of a Recognised Professional Body and demonstrate that they are fit and proper to conduct audit work. These requirements are unchanged. We do, however, propose some revisions to the experience requirement for an Audit Principal.
22. Currently, the DFSA requires an Audit Principal to have at least five years of relevant financial services audit experience in the past seven years. In keeping with the Australian and Singaporean regimes, and consistent with recent modifications granted, the DFSA proposes to amend the requirement to be five years of relevant audit experience in the past seven years.
23. Additional amendments are proposed to ensure that Audit Principals have sufficient experience to supervise and manage the conduct of an audit. Specifically, it is suggested that the five years of experience must be accumulated after acquiring a relevant qualification. This is a common timeframe required by professionally qualified accountants to rise to a managerial capacity in audit firms. It is also proposed that, of the five years' experience, at least one year should be in a managerial role, supervising and finalising audits (see AUD section 2.4).

Issue for consideration

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

Suspension and withdrawal of Audit Principals

24. Under the proposed changes to the Regulatory Law (see proposed Article 102), the DFSA would have the power to suspend or withdraw the registration of an Audit Principal on its own initiative or at the request of the Registered Auditor or Audit Principal. A decision taken on the DFSA's own initiative to suspend or withdraw an Audit Principal's registration could be taken when, for example, the Auditor is considered to be no longer fit or proper, or has otherwise breached the Regulatory Law or DFSA Rules. Prior to exercising this power, the DFSA must explain the reasons for the decision and provide a suitable opportunity for the Audit Principal to challenge the decision. If a decision to suspend or

withdraw a registration still follows, this is appealable to the Regulatory Appeals Committee (RAC).³ In the case of withdrawing the registration of an Audit Principal on the DFSA's own initiative, generally, the DFSA will only consider exercising this power after conducting an investigation.

25. In the event that an Audit Principal's registration is suspended, it is proposed that the Audit Principal must not - with regard to clients which are Domestic Firms, PLCs or Domestic Funds - manage the conduct of any audit work undertaken by a Registered Auditor nor sign any audit reports, or other reports required by the DFSA, on behalf of the Registered Auditor.
26. It is proposed that an application to withdraw an Audit Principal's registration may be made by the Registered Auditor or Audit Principal. For the DFSA to grant such a request, it must be satisfied that the Registered Auditor would continue to have at least one individual appointed by it to undertake the responsibilities of an Audit Principal and that the Registered Auditor has made appropriate arrangements with existing audit clients which are Relevant Persons (Domestic Firms, Domestic Funds and PLCs) (see AUD section 3.3).
27. Given the interdependency between the Registered Auditor and the Audit Principal, it is proposed that an Audit Principal's registration is withdrawn when his employment ceases with a Registered Auditor (see proposed Regulatory Law Article 102).

Issues for consideration

3. Are the DFSA powers to suspend and withdraw the registration of an Audit Principal appropriate? If not, why not?
4. Is it appropriate that either the Registered Auditor or Audit Principal may apply for the withdrawal of an Audit Principal's registration?

Part 2: Auditor Independence

Mandatory Rotation

28. To ensure independence, Registered Auditors are required to adhere to the IESBA Code. Among other things, the IESBA Code mandates the rotation of key audit staff every seven years when the client is a public interest entity - effectively a PLC under the DFSA regime. We propose to make this existing requirement explicit by introducing a Rule requiring the rotation of the Audit Principal after a period no less than that set out in the IESBA Code where the client is a PLC (see AUD Rule 5.2.2).

Issue for consideration

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

Provision of Non-assurance Services

29. Auditors commonly provide non-assurance services to audit clients. This can

³ Please also see [CP90](#) for proposed changes to the RAC. In future, it is proposed that the right to refer a decision for review would be to the Financial Markets Tribunal.

create threats to the independence of the audit firm and audit staff (e.g. preparing financial statements, and then auditing the same statements, calls into question the independence of the auditor and creates a conflict of interest). The IESBA Code acknowledges that it is not possible to create an exhaustive list of permissible non-assurance services given continual changes in business practices, technology, etc. Instead, the IESBA Code contains a conceptual framework which makes clear that non-assurance services which involve some management responsibility (i.e. making significant decisions about the use or control of resources of the client) should not be provided by an auditor that is also providing assurance services to the same client.

30. An Auditor is required to exercise judgement in determining whether or not the provision of a non-assurance service involves management responsibility. The DFSA proposes prohibiting the provision of the following non-assurance services to audit clients, as we consider these services always involve management responsibility (see AUD Rule 5.2.1):
- (a) Compliance Officer;
 - (b) internal audit; and
 - (c) preparation of accounting records or financial statements.
31. This approach is consistent with the IESBA Code, the preface to which recognises that in some jurisdictions auditors may face requirements that are more stringent than those contained in the Code.
32. The intention of this proposal is not to create an 'audit only' regime for Auditors, who may continue to provide:
- (a) non-assurance services, other than those listed in paragraph 30, to their audit clients, provided those services do not involve the assumption of management responsibility; and
 - (b) a full range of non-assurance services, including those listed in paragraph 5, to their non-audit clients.
33. For non-assurance services that are not prohibited by the DFSA, an Auditor must continue to identify, evaluate and manage all potential threats to its independence (e.g. those deriving from self-interest, self-review, familiarity), as set out in the IESBA Code.
34. Following on from initial discussions with the small population of Auditors affected by the proposed changes, no transitional arrangements are felt to be needed in relation to the introduction of explicit prohibitions on the provision of non-assurance services to audit clients.

Issue for consideration

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

Part 3: Miscellaneous requirements for Registered Auditors

Suspension by the DFSA

35. Amendments to the existing regime are proposed to provide clarity on permitted activities in the event that the registration of a Registered Auditor is suspended by the DFSA. During a period of suspension, it is proposed that a Registered Auditor must not accept any new audit clients or agree to be re-appointed by an existing client, where that client is a Domestic Firm, PLC or DF. Additionally, it is proposed that during a suspension, a Registered Auditor is not permitted to issue an audit report in regard to a Domestic Firm, PLC or DF, without the prior written consent of the DFSA. The latter restriction is consistent with practices in Australia and the USA (see AUD section 3.2).

Issue for consideration

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

Notification of changes

36. The DFSA is proposing to revise the existing requirements for a Registered Auditor to notify the DFSA of certain matters relating to its registration. Under the proposed changes, developments requiring notification to the DFSA are grouped into three categories, namely core information (e.g. the name of the Registered Auditor); regulatory impact (e.g. a Registered Auditor failing to satisfy fitness and propriety requirements); and those relating to regulators outside the DIFC (e.g. refusal to grant an application). Any changes to core information should be disclosed to the DFSA with reasonable advance notice. Any changes with a regulatory impact or relating to developments from other regulators must be immediately notified to the DFSA. These proposed changes are designed to encourage more comprehensive and timely communication with the DFSA (see AUD section 4.6).

Applicants for registration as a Registered Auditor

37. The DFSA is proposing to amend its practice so as to include sole practitioners as an acceptable legal form for Registered Auditors. This is supported by the benchmarking of leading jurisdictions and is in keeping with legal forms allowed by the Companies Law 2009. Specifically, a Registered Auditor in the form of a single-member corporate body is already acceptable, provided – of course – that it meets the criteria for registration. We feel there is no significant difference in risk between a sole practitioner and a single-member corporate body, all other things (e.g. competence and experience of staff) being equal, so sole practitioners should also be allowed to be Registered Auditors, provided they – similarly - meet the criteria for registration.
38. The DFSA proposes some modest changes to the criteria for applicants to register as a Registered Auditor. In particular, to address a deficiency identified from operational experience, an explicit requirement is proposed for applicants to have clear and comprehensive policies and procedures for compliance with their legal obligations and adequate means for implementation of those policies and procedures (see AUD section 2.2).

Professional indemnity insurance (PII)

39. The DFSA currently requires Registered Auditors to hold adequate PII cover. Adequacy, however, is not defined. The DFSA has determined, via on-site risk assessments, that Registered Auditors commonly do not have an appropriate mechanism in place to determine adequate PII cover. As such, an express provision is proposed which requires a Registered Auditor to maintain relevant records and all relevant information relating to how it established the adequacy and appropriateness of its PII cover (see AUD section 4.3).

Annual Information Return

40. In keeping with benchmarked jurisdictions and formalising current practice, the DFSA proposes to add an express provision requiring Registered Auditors to submit an Annual Information Return form to provide an overview of the audit firm, including its staff and clients. The contents do not vary from what is currently requested by the DFSA and, as such, this is not considered to impose a regulatory burden. Under the proposals, Registered Auditors would be required to complete and submit the form to the DFSA by 31 January each year for the preceding calendar year (see AUD Rule 4.8.1).

Conduct of audit and preparation of reports

41. Authorised Persons have existing requirements relating to the work that must be conducted by their Auditor. It is proposed that an Auditor be made directly responsible for the conduct of audit and related work, and preparation of relevant reports. This is a formalisation of existing implicit obligations on Auditors. The reports are, depending on the nature of the client, Financial Statements Auditor's Report, Regulatory Return Auditor's Report, Client Money Auditor's Report, Insurance Monies Auditor's Report, Safe Custody Auditor's Report, Fund Auditor's Report and Public Listed Company Auditor's Report.
42. To enhance the sense of personal responsibility, and in keeping with international best practice, it is also proposed that Auditors should include the name of the Audit Principal (or if it is not a Registered Auditor, the name of the relevant individual) responsible for the work conducted on each report submitted to the client (see AUD chapter 6).

Working Papers

43. Greater clarification of the meaning of 'Working Papers' is proposed to be provided by defining the term in GLO (see Appendix 9). We are also proposing to clarify the DFSA's expectations for the maintenance of Working Papers of Registered Auditors which are providing audit services to a Group (which may include entities outside of the DIFC) or a Registered Auditor seeking to rely on materials prepared by third parties in connection with the audit of a Group.

Issue for consideration

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

Practice Notes

44. In line with leading audit regulators, the DFSA proposes to introduce 'Practice Notes'. Practice Notes will be issued from time to time, to assist auditors in

applying generalised auditing standards to more specific circumstances.

Part 4: Fees

45. The DFSA currently charges two types of fees to Registered Auditors – an application fee for registration and a periodic fee for on-going supervision (usually paid annually for a twelve-month period). The fees are currently set at USD4,000 and USD6,000 respectively. The amounts are unchanged from when the auditor regime was first introduced on 28 December 2006.
46. The DFSA has considered the nature and level of fees charged to Registered Auditors, including whether there should be a differentiated approach to auditors of PLCs - for which bespoke regulations were introduced in November 2011 - and other auditors. In developing the proposals, reference was made to arrangements in other jurisdictions. While the DFSA does not have a policy of full cost recovery, as is common in other benchmarked jurisdictions (e.g. Canada and the UK, as well as the USA), costs incurred have been considered in the proposed amendments to the fee structure. At the time the auditor regime was introduced, there was little knowledge of the likely costs of the regime. However, there are now a number of years of records (i.e. DFSA staff time and external support for undertaking larger and more complex risk assessments), enabling much improved estimates to be made of the cost of administering the regime. The DFSA also considered the likely impact on Auditors' commercial viability of the proposed changes in fees.
47. The revisions below are proposed to take effect in 2015. That is, no changes to fees are proposed for 2014.

Application Fee

48. The nature of the application fee is proposed to remain unchanged as a flat rate. This structure is commonly found in leading jurisdictions and is consistent with the largely uniform costs incurred by the DFSA in processing applications. The level of the fee is proposed to be revised from USD4,000 to USD10,000, reflecting in large part the improved estimates of actual costs described in paragraph 46.
49. The application fee is proposed to be the same for all applicants for registration as a Registered Auditor, whether or not they are engaged in auditing PLCs. (see proposed FER Rule 2.3.1 in Appendix 5).

Periodic Fee

50. The nature of periodic fees charged is proposed to be amended from a flat rate (USD6,000) to a variable rate, dependent on the number of audits conducted under the DFSA regime. The shift in fee structure for Auditors of AFs, AMLs and DFs is consistent with practices in leading jurisdictions. Additionally, a variable structure will result in a more equitable distribution of the DFSA costs of supervision among Registered Auditors. Those Registered Auditors conducting a large number of audits (over 15 in a year) generate a higher cost of supervision given the higher frequency and greater complexity of their risk assessments.
51. The following tiered structure for periodic fees is proposed for Registered Auditors of AFs, AMLs and DFs:

DFSA audits conducted (number)	Periodic fee (USD)
0-15	7,000
16-30	14,000
31 or more	21,000

52. The nature of regulatory oversight for Registered Auditors of PLCs differs from that of Registered Auditors providing services for other entities. Auditors of PLCs face a higher frequency and intensity of supervision, given the public interest aspect of these entities. At the same time, there are very few PLCs in the DIFC. With these considerations in mind, the DFSA proposes to introduce a flat periodic fee of USD20,000 for Registered Auditors of PLCs (see proposed FER section 3.6).
53. As noted above, the DFSA does not have a formal policy of seeking to recover its full costs from those it regulates. However, it will be the DFSA's approach to seek to recover a larger proportion of such costs in the future than is the case now. Any future changes in this direction will follow:
- (a) careful consideration of the impact of any potential fee change on the regulated (and potential regulated) community; and
 - (b) full public consultation.

Issues for consideration

- 9. Does the nature of fees proposed (i.e. flat and variable) seem appropriate? If not, why not?
- 10. Does the level of fees proposed pose any significant concern about the commercial viability of Registered Auditors' operations in the DIFC?

Part 5: Requirements applicable to AFs, AMIs, PLCs & DFs

Financial reporting standards

54. The DFSA proposes introducing the option for certain firms to apply a reduced set of financial reporting standards in preparing their financial statements. Currently, the DFSA requires AFs and AMIs to prepare and maintain all financial accounts and statements in accordance with International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB). In 2009, the IASB issued a simplified version of IFRS for small and medium-sized entities ('IFRS for SMEs'). Consistent with the IASB, the DFSA proposes to prohibit the application of IFRS for SMEs for entities which have public accountability (e.g. listed entities).
55. The DFSA considers that, for smaller entities, the application of 'full' IFRS may impose an undue burden as many of the requirements are irrelevant and do not justify the required cost and effort. The application of IFRS for SMEs is increasingly common around the world and is present in the majority of jurisdictions benchmarked. A number of firms have also approached the DFSA seeking to use 'IFRS for SMEs.'
56. The DFSA proposes that AFs in Prudential Category 3B, 3C or 4, which do not

hold or control Client Assets or Insurance Monies may apply 'IFRS for SMEs' in the preparation and maintenance of all financial statements. Firms in Prudential Category 4, which do not hold a Licence to carry out the Financial Service of Operating an Alternative Trading System, may also apply 'IFRS for SMEs.' It is also proposed that the DFSA will have the power to direct Authorised Persons to apply 'full IFRS' if this is deemed appropriate considering the Firm's size, risk profile, etc.

57. Application of IFRS for SMEs will only impact the AF's audited financial statements and will not affect any of the prudential or other reporting and disclosure requirements (see proposed GEN section 8.2 in Appendix 4).

Issue for consideration

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

Conduct of audits and audit reports

58. Authorised Persons have requirements relating to the reports that must be produced by their Auditor (e.g. Financial Statements Auditor's Report, Regulatory Return Auditor's Report, Client Money Auditor's Report; see GEN Rule 8.6.1). To assist both Authorised Persons and their Auditors, the DFSA proposes to elaborate on the relevant standards appropriate to each return and to introduce a differentiated approach to reporting requirements for Domestic Firms and Branches, as regards the Financial Statement Auditor's Report and Regulatory Return Auditor's Report (see proposed GEN Rule 8.6.1 and AUD App1).
59. The substance of the current requirements relating to the audit of regulatory returns and financial statements applicable to Authorised Persons and Auditors is largely unaffected by these proposals. Some modest re-drafting is proposed to encourage a shift in focus away from year-end figures for the audit of regulatory returns, with particular regard to capital adequacy. Both quarterly and annual regulatory returns are proposed to be reconciled with audited annual financial statements. That is, account must be taken of regulatory capital calculations reported in an AF's quarterly returns while auditing the annual returns. The policy intention is not to require a separate audit of quarterly returns (see AUD Rule A1.1.1).
60. Requirements relating to regulatory returns have also been aligned with the recently amended PIB rules, for example, the liquid asset requirement introduced for AFs in Prudential Categories 3B, 3C and 4 (see AUD Rule A1.1.1).
61. To assist Authorised Persons and Auditors, the DFSA proposes to set out the required contents of audit reports in the Appendix of the AUD Module. For AFs and Auditors required to submit Client Money, Insurance Monies and Safe Custody Auditor's Reports, reports will need to be submitted even where there is a zero balance at the date on which the AF's audited balance sheet was prepared (i.e. a nil report is required) (see AUD Rules A2.1.1(a), A3.1.1(a) and 4.1.1(a) and Guidance to those Rules).

Notifications regarding Auditors

62. Authorised Firms, AMIs, PLCs and DFs must currently notify the DFSA

regarding the appointment, resignation and/or termination of their Auditor. To support a more efficient process, the DFSA proposes to introduce a 'Change of Registered Auditor' form. This is not anticipated to result in any increased burden on Authorised Persons, PLCs or DFs as it merely formalises the information currently required by the DFSA in these circumstances.

63. Authorised Firms, AMIs, PLCs and DFs must also notify the DFSA if an auditor is, or relevant audit staff are, no longer independent (see GEN Rule 8.4.4).

Approval of financial statements by Directors or Partners

64. In practice, financial statements are generally approved by Directors and signed on their behalf by a single Director. Currently, this is not a requirement for AFs in our Rulebook and the relevant provision in the Companies Law 2009 is not applicable to AFs. To close this gap in our regulatory regime, it is proposed that a rule be introduced requiring at least one Director or Partner, as appropriate, to sign an AF's financial statements on behalf of all Directors or Partners (see proposed GEN Rule 8.2.4).

Financial year-end

65. The DFSA proposes to introduce a definition of financial year for AFs, by setting out in a Rule its practice of permitting an AF to designate its first financial year for a period of up to 18 months. This is consistent with the Companies Law 2009 and practices in other jurisdictions (see proposed GEN Rule 8.3.5).

Disclosure of financial statements

66. GEN Rule 8.6.3 requires an Authorised Person to provide on request, to any Person, a copy of their most recent financial statements, together with the auditor's report. The DFSA has considered whether the scope of this Rule remains appropriate, i.e. whether it should continue to apply to all Authorised Persons.
67. In order to remain in line with international standards⁴, the DFSA considers that it is necessary to require disclosure of financial statements by at least those firms in PIB categories 1, 2 and 5, together with insurers and listed entities.
68. The benchmarking on disclosure of financial statements by firms other than those listed in paragraph 67 gives a mixed picture. In some jurisdictions (e.g. the UK) broader disclosure is a consequence of company law, and not of financial services regulation.
69. We have considered the public interest arguments for disclosure for firms that do not fall into the categories in paragraph 67. For these other types of firms, the public interest argument for disclosure is strongest for those firms who hold the money or other assets of their customers. The experience of other jurisdictions is that when a regulated firm is in financial difficulties, the segregation between firm and customer money is more likely to break down. Public disclosure of financial statements of a firm engaged in financial services, so that current and potential customers of such a firm can scrutinise the firm's financial health, appears to us to serve a useful and necessary purpose. The public interest argument for disclosure is less strong for those firms that never hold the money

⁴ For example, with principle 27 of the Basel Core Principles on Banking Supervision and principle 20 of the IAIS's Insurance Core Principles.

or other assets of their customers, and is in our view balanced by the right of private companies to maintain at least a degree of privacy about their affairs. On balance, it appears that for such firms any public interest argument is not sufficiently strong to outweigh the right to privacy.

70. The DFSA proposes to change the scope of GEN 8.6.3 so that the requirement to disclose, on request, financial statements, does not apply to those firms in PIB categories 3B, 3C or 4 that never hold client assets or insurance monies.

Issue for consideration

12. Do you have any comments on the DFSA's proposals to amend GEN 8.6.3?

In particular, do you think there are further public interest arguments for requiring all firms to disclose, on request, their financial statements? If so, what are those arguments?

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