Assess the need to providing consultancy services by internal auditing

Technological developments and challenges facing internal auditors

Suggestions to overcome the challenges experienced by family businesses
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Dear Readers,

The International Conference 2018 scheduled from May 6-9 seems a good 6 months away, but I can assure you that at the IIA offices things are extremely busy with the board, executive committee, volunteers and staff working hard behind the scenes to ensure a highly successful conference. Our aim is to ensure an experience never felt before by the delegates in any other conference. We are also setting our sights extremely high and are seeking to break all records achieved by the earlier conferences.

We are extremely privileged to have received the Patronage of His Highness Sheikh Mohammed bin Rashid Al Maktoum, Vice President and Prime Minister of the UAE and Ruler of Dubai for the International Conference. This is a huge honor for us at the UAE IAA.

Several road-shows for the IC 2018 have been conducted and members of the board, executive committee and staff have attended them in Kuwait, UK, Malaysia, Indonesia and Korea. The response has been extremely satisfying and several enquiries have been made with the officials present. The members have also started enquiring on the details of the conference and have expressed their support. We are calling for volunteers who are willing to be a part of this mega-event. Please reach out to us by emailing at info@uaeiaa.org your details.

The 7th Chief Audit Executive Conference is scheduled to be held from December 12-13 in Dubai. We are glad to announce that the President and CEO of IIA Global, Mr. Richard Chambers will be gracing the event and is one of the keynote speakers. The event will also include the 3rd cycle of the Best Practice Awards in Internal Audit. This year’s cycle has been extremely positive with a good number of entries from several first time organizations. We wish them all the best.

Regards,

Abdulqader Obaid Ali
President
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My Internal Auditor is My Internal Consultant
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By Slobodan Dimitrovsk
All thanks and appreciation to the author of the article, Mr. Ninad Pradhan, on such an important article “The Journey to Excellence in Internal Audit”. He pointed out two important points, the first of which is conducting an independent assessment by an external auditor every five years and informing the Audit Committee of its results, and the second is calling for a quality assessment by the Chief Audit Officer rather than the Audit Committee due to its “no favorable” impacts on the assessment process.

However, despite the importance of the aforesaid two points and the fact that the independent assessment process constitutes one of the governance elements that must be observed by the companies and is considered as an obligatory requirement by the regulators for the companies listed on the stock markets and performing securities-related activities, companies believe that this step is unnecessary and increases their financial burden, so they implement it at the lowest possible cost, which negatively impacts the objective of such a step and leads to a lack of professionalism and transparency. The Chief Audit Officer’s call for conducting quality assessment must be done in coordination with the Audit Committee in order to interact with it and adopt its observations. Finally, achieving excellence in internal audit and quality enhancement depends primarily on the employees’ belief in the culture and values of the establishment. This has been expressed by the author of the article; however, retaining employees who do not believe in this culture and values is one of the biggest threats facing establishments and must be dismissed in this case. Furthermore, excellence must be maintained and transferred through the establishment’s talented and excellent employees who are capable of sustaining success, professional and organizational innovation, noting that the management’s role in this regard is attempting to attract and retain them.

Dr. Ayman Fathi El Ghabari
Financial Advisor
State Audit Bureau in Kuwait

Comment on the “Self Service Audit Analytics” article:

I would like to thank the author of the article and the editor for addressing the matter of Self Service Audit Analytics and its relationship with continuous audit, as all studies firmly confirm that the use of technology in internal audit is inevitable. Due to the importance of this matter, it has been addressed frequently in the research literature of internal audit; especially in the basic principles of internal audit, which stipulate that the internal auditor should have a forward-looking approach, and accordingly the view of traditional or historical audit has changed to analytical and immediate audit.

In my opinion, the internal audit profession will change drastically in the coming years, with a higher degree of dependence on technology in auditing and analysis. This requires Chief Audit Executives to invest more and more in the available technologies and analytics, especially the "real-time data analysis" based audit. Moreover, Chief Audit Executives shall develop standards and indicators directly related to available data, so that internal auditors can promptly perform audit tasks with less time and effort, and without disturbing the audited entities to obtain required data.

This requires, as the author pointed out, developing the skills of the audit team, using the appropriate tools and software and attempting to benefit from the IT Department to facilitate and eliminate any technical barriers to the optimal use of available technologies.

Bassem Hijaz
Chief Audit Officer of Nadec and Vice President of the Jordan Internal Audit Association

QIAL, CIA, CPA, CISA, CCSA, CFE, CRISC
Internal Audit in the matrix of digital world

- SAVE THE DATE -

7th CAE Conference
12th & 13th December, 2017
Rixos Premium, JBR, Dubai
Is audit ready for blockchain?

As demands from capital markets and investors are ever increasing for more information about businesses, there is no surprise that the audit profession is keenly looking at blockchain as this could fundamentally change the nature of auditing by transforming supply chains, payments and revenue streams through the way it documents and reconciles complex and distinct information from multiple sources. Due to this, every transaction could be shared among trusted parties and verified, providing increased transparency, confidence and trust, at the same time increasing efficiency, as the blockchain is regarded as a “central point of truth.” Also, through its almost real-time reporting to the management, blockchain could provide access to quality data which current systems are not able to deliver.

These shifts may not happen in short span of time as implementing blockchain will require significant investment in systems and processes to meet its objective of creating a more secured, transparent and efficient system, which eliminates the need for the time-consuming financial checks exist today.

Following are few of the key considerations that need to be in place before the technology can meet business needs for blockchain adoption:

- System confidence
- Audit strategies
- Financial accounting, reporting and legal standards
- Cyber and software auditing

Ethics and the Internal Auditor

In the current unsettled situation, ‘ethics’ continues to be a recurring conversation topic of corporate, shareholder, stakeholder and regulatory bodies. For internal auditors, ethics can be a very delicate issue and political quandary while attempting to execute their responsibilities and fiduciary duties. Internal auditors are often put in positions where they have to make difficult and sometimes uncomfortable inquiries as well. This can appear as an attack on personal integrity or on personal morals and ethics of the management.

Hence, a code of ethics is necessary and appropriate for internal audit profession. Ethics are grounded in the fact that management and stakeholders have a significant level of trust in the internal audit function. Establishing a code of ethics is not as simple as it sounds. Some of the important attributes of ethics to be considered, by using the ‘EITHICS’ word as a mnemonic for the following points:

E – Everyone is responsible
T – Tone at the top is essential
H – Honesty is the best policy
I – Integrity is a must
C – Corporate social responsibility is expected
S – Silence is not acceptable (or silence is a form of acceptance)

http://misti.com/internal-audit-insights/ethics-and-the-internal-auditor

https://www.accountingtoday.com/opinion/is-audit-ready-for-blockchain?feed=00000158-20c3-d6a2-adfb-70eb31330000
A fundamental shift in the way banks manage risk

A global bank risk management survey was conducted by EY in collaboration with the Institute of International Finance (IIF) to explore key focus areas and challenges for banks as they move through three distinct phases of a 15-year risk transformation journey. Following three key findings emerged from this year's survey:

- After fully rationalizing structures and processes, banks will have to drive digital transformation across the entire operations, from customer to operations
- Risk management functions should reinvent themselves to become enablers and drivers of innovation and growth, leveraging technology to do so
- Cybersecurity is not ahead of regulatory matters as the top concern of Boards and Chief Risk Officers

Banks are implementing technology-driven change

As the industry's digital transformation has accelerated, banks will have to move from exploring to implementing use of new technologies across the bank i.e. in the middle and back office. This will challenge banks risk functions to change how they have been monitoring risk profiles of the bank and facilitate innovation, and how they leverage new techniques to be smarter, faster and more cost-effective.

- As banks are taking action to cut costs, from operational streamlining to technology-driven transformation, 83% of banks are focused on data analytics over the next three years
- Plans to leverage new technologies to manage costs are in various states of progression i.e. digital and mobile infrastructure initiatives are the most advanced, while banks are taking first steps to automation and machine learning
- As banks reinvent themselves using technology to drive digital change in the future, risk teams are also expected to do so

Following are the five challenges for banks:

i. Managing emerging risks and increased competition
ii. Leading a digital transformation of risk management
iii. Operationalizing three-lines-of-defense models
iv. Managing non-financial risks cost-effectively
v. Staying resilient and protecting against cyber risks


Top changes to the COSO ERM Framework: Enterprise Risk Management Integrating with Strategy and Performance

Why update the COSO ERM Framework?

There are several reasons to update the COSO ERM Framework such as:
- The complexity of doing business is changing
- New risks continue to emerge at a faster pace than has been seen in the past
- Shifting customer behavior

In the meanwhile, technology evolution as well as increased need of transparency are straining strategic planning processes and operational capabilities. These challenges require that organizations need to take a new approach to managing risk which helps to create, preserve and realize value now and in the future.

Following are some of the key changes to the Framework:

1. A new structure is introduced
2. Different benefits of ERM are explored
3. Focus on integrating risk management is provided
4. Written from the perspective of business
5. A suite of new graphics is featured
6. Risk management at all altitudes of the organization is explored
7. Dives into deeper discussions on challenging topics
8. Increased emphasis on culture
9. Evolving role of information technology is addressed


Workforce of the future - The competing forces shaping 2030

73% think technology can never replace the human mind
70% would consider using treatments to enhance their brain and body if this improved employment prospects in future
74% are ready to learn new skills or completely retrain in order to remain employable in the future

Jobs at risk: automation by country

38% US
35% Germany
30% UK
21% Japan

A big delegation headed by UAE IAA Chairman, Abdulqader Obaid Ali, attended the Internal Audit International Conference 2017 hosted by IIA Australia in Sydney from 23rd – 26th July 2017. The UAE IAA had a large booth at the exhibition centre which was appreciated by the visitors as one of the best booths.

The Department of Tourism & Commerce Marketing (DTCM) and the UAE Embassy in Australia supported UAE IAA in setting up an Arabic traditional tent where Arabic coffee and dates were served to the visitors.

Conference attendees visited the UAE IAA booth to avail of its hospitality and to gain more information on the upcoming Internal Audit International Conference 2018 due to be held in Dubai from 6th – 9th May under the patronage of HH Sheikh Mohammed bin Rashid Al Maktoum.

During the last day of the conference, an official flag handover ceremony was conducted where the IIA Australian chairman passed the IC 2018 flag to the UAE delegation headed by HE Matar Ali Al Mansoori, Deputy Chief of Mission, UAE Embassy in Australia.
H.E. Major General Mohammed Ahmed Al Marri, director general of General Directorate of Residency and Foreigners Affairs (GDRF) – Dubai, received in his office a delegation from the UAE Internal Auditors Association, headed by its chairman Abdulqader Obaid Ali.

During the meeting, His Excellency appreciated the association for its on-going efforts and effective partnership towards performance development and improving the level of auditing, governance and risk in GDRF.

UAE IAA Hospitality Sub-group event in July

UAE IAA Hospitality subgroup held a session on VAT in UAE and the role on an auditor

VAT introduction session was with a specific focus on the hospitality sector
Are your organization’s IT control systems reliable?

There is no doubt that all small, medium and large organizations have Information systems, whether computerized or manual. These systems are used for processing the data and extract a large amount of useful information which represent a main source for decision-making inside and outside the organization. The information systems must be highly reliable. To be so, it must have five key principles: safety, confidentiality, privacy, processing Integration and availability.

**Safety**

It is the main element of these principles. Despite the complexity of information systems security, and the need for information security specialists, but it is the matter of senior management within the organization and not only the information technology department, as the senior management is responsible for the accuracy of the data and reports issued by the organization.

**Time Security Model**

This model evaluates the effectiveness of the organization’s security by measuring and comparing the relationships among the following three variables:

- **P**: The time it takes for an attacker to break through the preventive controls of an organization.
- **D**: The time it takes to detect the occurrence of the attack.
- **C**: The time it takes to respond.

If **P** > (**D** + **C**), then, security measures are ineffective. Otherwise, security measures are effective.

This model is also used for comparing and assessing cost and benefits of controls implementation. For example, if your organization will invest 10,000 cash units to improve security and have the following options:

- Buy a firewall that will add 15 minutes to **P** duration.
- Update the intrusion detection system that will reduce **D** duration by 18 minutes.
- Invest in a new method of quick response to the intrusion process to reduce **C** duration by 20 minutes.

Certainly, the third option, i.e. investing in a new method, will make the organization more beneficial while other factors shall remain unchanged.

**Defense in depth**

The defense in depth includes the use of multiple layers of controls to avoid existence of gaps that may hinder the operation of the system or be vulnerable to for cyber attack. So, the computer security includes the use of a set of firewalls, passwords, and other preventive, detective and corrective countermeasures to prevent unauthorized persons from getting an access to systems, data and devices.

**First: Preventive Controls**

Key types of preventive controls used for information systems include:

- **Authorization**: This control determines who is authorized to access the system by either giving him a password, a fingerprint or an access card.

- **Authentication**: It is another layer of preventive controls in which the permission for accessing the subsystems is given after confirming that the employee has an access permit to the master system. Appropriate privileges must be given according to the job description of the employee.

- **Training**: Staff should be trained on how to protect and maintain their PCs, and employees should be made aware of social engineering and its methods of cheating the employees.

- **Physical Access Controls**: The main server room must be protected from unauthorized access through the access card or fingerprint. Visitors must be accompanied while roaming the premises of the organization and PCs must be protected from misuse.

- **Remote Access Controls**: There are
several technologies used to protect data and systems from manipulation, including routers, firewalls, and intrusion prevention systems.

- **Main Router**: It is used to connect the information system to the Internet.
- **Firewalls**: It works in conjunction with the main router to filter information transmitted in or out of the information system.
- **TCP/IP Protocol**: It is used to communicate data in the form of streams of bytes over the Internet. Through this protocol, a set of rules called the Access Control List “ACL” is used to determine the accepted/rejected data streams. The most effective data filtering technique is Intrusion Prevention Systems.
- **Internal Firewalls**: They are used to divide departments and divisions within an organization so that a particular department or division cannot access to the information systems of the other division.
- **Put key computers such as e-mail computers in a separate network outside the company's internal network.**
- **There shall be special procedures for wireless network security.**

**Encryption**: Encryption is the ultimate block in the development of preventive controls, through which data is converted from clear readable text to cipher unreadable data, and data can be returned to normal when needed.

The role of the internal auditor in ensuring the effectiveness of preventive controls:

The role of the internal auditor is to ensure that procedures and techniques are used effectively and efficiently, for example:

Request the IT Department to provide a list of all the addresses and websites that accessed the information systems through the main router, as well as the websites and addresses that were prevented from entering through intrusion detection systems and firewalls. This will be useful, particularly upon noticing the repetition of certain websites and addresses.

Second: Detective Controls:

There are no preventive systems capable to completely protect the information systems from cyber attacks due to the continuous evolution of attackers’ methods and inherited vulnerabilities in any information system. Hence, there should be controls that detect any attempt to attack the information systems. Through detective controls, the effectiveness of preventive controls systems is determined.

**Log Analysis**: It is a file that records all user's activities, e.g. deleting, modifying, and adding database records.

**Intrusion Detection Systems (IDS)**: It creates a log of addresses and websites that are allowed to pass to the firewall.

Management Reports:

Creating management reports that include Key Performance Indicators in terms of the business disruption due to security incidents, the number of installed, maintained and developed systems, and the time required to respond to the detected security incidents.

Information System Security Testing:

There are many techniques that can be used to examine the system and detect vulnerabilities and weaknesses, where a person can try penetrating the information system (authorized person or security consulting company) to identify and handle gaps and vulnerabilities.

Role of internal auditor in ensuring the effectiveness of detective controls:

The role of the internal auditor in assessing the detective controls include ensuring whether or not the administrative reports are prepared and the audit trail/log file is effective, where the internal auditor can request a specific sample from the log file analysis and ensure that all transactions/activities in the file were made by authorized users, and match the privileges granted to the users with the user access authorization matrix.

Third: Corrective Controls:

They include ensuring that all identified vulnerabilities and weaknesses have been corrected. These controls include:

**Computer Emergency Response Team (CERT)**: It consists of technical and operations management specialists to handle major incidents and regularly:

- Recognize the problem;
- Contain the problem;
- Solve the problem; and
- Follow-up.

**Chief Security Officer**: A specific individual responsible for the organization's scope of security. Such a person should report to the COO or CEO and be independent of the information system management functions.

Ahmed Salameh Al-Malaji, Accounting Information Systems - Internal Auditor at the Land Transport Regulatory Authority / Jordan
What made you become an internal audit leader in a higher education institution?

Internal Audit is a challenging profession. I formerly worked at ADCO, SCAD and other government organizations. The education industry is dynamic in nature and mostly is non-profit oriented. I interact with highly qualified and intellectual professors and administrators which gives me insights into the challenges faced in the industry. The experiences I have gained during my career have shaped me into an internal audit leader. Further higher education helps to uplift the young UAE nationals and I advocate and support education of young UAE nationals to develop and contribute to our country.

What are some of the potential challenges that internal auditors may face when auditing a higher education institution?

These include maintaining relationships with academics and non-academics, creating awareness regarding the role of internal audit and compliance in the context of the university, following Abu Dhabi Accountability Authority (ADAA) guidelines, maintaining independence while assisting the management, cost cutting pressures due to budget constraints, obtaining effective data for audit purposes, maturity of the organization etc.

What are some specific risks that should be taken into account when dealing with internal audit in higher education institutions?

The specific risks include creating an audit culture based on the maturity level of the organization, reputational risks involved due to involvement of students, cyber security risks, risks of accreditation, budget constraints etc.

We understand that managing reputation risk is of utmost importance at higher education institutions. What can internal audit do to support this?

Internal audit can create a robust anti-fraud program, fraud awareness sessions, auditing culture, auditing social media to manage the reputation risks in the higher education institutions. Also internal audit can advocate the need for a whistleblowing channel to enable the stakeholders to highlight any fraudulent activities in the organization.

How is technology changing the way internal audit works at a higher education institutions?

There are lot of online courses available to educate ourselves regarding the changing nature of internal audit. Further the technology has made our life easier and helped us to obtain information in the shortest possible time. Also I recommend all internal auditors to attend the UAE IAA conferences to obtain more information and knowledge regarding the emerging key areas in the internal audit professions.

Do you have any advice for other internal audit leaders in higher education?

My advice would be to develop a healthy internal audit environment in the organisation with the support of management. The aim of internal audit leaders should be to go beyond the traditional auditing methods focusing on compliance and emphasize more on performance auditing and improving the existing processes and provide advice on innovative and cost saving measures in the organisation.
OVERVIEW
By now, majority of the audit community is already aware that UAE, as well as other GCC countries will start implementing Value Added Tax (VAT) effective 1st of January, 2018. Rest of the GCC countries will follow by January 2019. A Federal Tax Authority (FTA) has been established to govern, manage the implementation process, collect federal taxes and apply the tax-related procedures. The VAT procedures are defined in the Tax Procedures Law, which has been approved recently. Two sets of administrative and tax evasion penalties have been defined in the Tax Procedure Law.

Although VAT will come into effect in less than four months, recent surveys conducted by professional firms concluded that GCC businesses are not yet prepared for VAT. Lack of VAT readiness exposes businesses to a new set of inherent risks that need to be managed by implementing a proper tax strategy and compliance framework.

Internal Auditors, as integral part of the governance framework of the business, are expected to add value to the VAT readiness project by providing their shareholders with an objective assurance on the adequacy and effectiveness of the internal controls and governance arrangements implemented in the project.

“Lack of VAT readiness exposes businesses to a new set of inherent risks that need to be managed by implementing a proper tax strategy and compliance framework.”

WHY IT IS IMPORTANT TO GET IT RIGHT THE FIRST TIME
Starting from the 1st of January, 2018, entities in the UAE will be required to collect, record, and pay the due VAT to the FTA. Registration with FTA will be opened in

GCC AND LOCAL VAT REGULATIONS
VAT will be governed by a unified agreement at GCC level, as well as by local laws and regulations. The unified agreement outlines the framework under which VAT can be implemented in each of the GCC member states and defines the principles on how to treat other GCC countries.

VAT in the UAE will be regulated by both Federal Law No. 8 of 2017 on VAT and the landmark Federal Law No. (7) of 2017 for Tax Procedures. Tax Procedures Law sets the foundation for the tax system and regulates the administration and collection of taxes by the FTA. The regulations define the VAT rates (5% and zero), the goods and services subject to VAT and exemptions, importation, the right of deducting input VAT and refunds, place of supply, VAT registration and payment, due dates, VAT return filing, and VAT invoice and record retention requirements.
the last quarter of 2017 and businesses that meet the registration threshold should register by the end of the year.

New compliance requirements will be introduced. Key accounting records will be mandatory for businesses with a certain annual turnover. Tax auditors will be visiting businesses to audit their revenue, operating expenses, contracts, and inventory. Attention will be given to every detail, such as all types of discounts, gifts, production waste, bad debt, and bonus paid to agents… etc.

Businesses can get ready for these changes and challenges in the business environment by implementing a proper VAT readiness project. VAT preparation and implementation is not a simple process that can be accomplished by just adjusting the accounting systems. In fact, it is a much wider process that needs a great deal of work and preparation in most of the business functions, including the commercial planning, procurement, sales, finance, IT, and customer service activities.

As a result, it is important to deal with this task as a structured project. A task force should be formed to oversee this project and to ensure the proper implementation of the tax strategy, systems, and processes right from the beginning. This task force should include members from various departments chaired by an expert. During the implementation project, all associated VAT risks should be methodically assessed and accounted for to avoid any future surprises, as well as to minimize the cost of implementation and to optimize future compliance.

**“Internal Auditors are expected to add value by providing an objective assurance on the adequacy and effectiveness of the internal controls and governance arrangements implemented in the project.”**

**PROACTIVE, NOT REACTIVE!**

In today’s highly competitive market where businesses are fighting for their market share, Boards are showing less tolerance in accepting risks, which may result in losing revenue or increasing cost. VAT money will belong to the government, so any errors made due to an inaccurate implementation of VAT will leave the businesses vulnerable, losing a portion of their profit or paying hefty penalties.

Depending on the existing level of expertise within the internal audit department resources, CAEs should plan their involvement by either providing a proactive consultancy service to help assess the risks and controls at an early stage, or by deciding to be involved at a later stage by conducting post-implementation audits.

_According to the standard 1210.C1 (Proficiency) of the IPPF._

The chief audit executive must decline the consulting engagement or obtain competent advice and assistance if the internal auditors lack the knowledge, skills, or other competencies needed to perform all or part of the engagement.

If the latter decision is taken, the CAE can still use the golden opportunity of participating as an observer within the task force. This will give Internal Audit a great deal of exposure in understanding the mechanism of implementing VAT, as well as changes within the existing systems and processes, project deliverables, and associated risks and controls. Taking part will also help the CAE in planning and phasing the future assurance audit, as well as identifying the scope and objectives of future audits. In the meantime, the internal audit team should start building and shaping their knowledge by attending VAT-related trainings and seminars.

**“VAT preparation and implementation is not a simple process that can be accomplished by just adjusting the accounting systems.”**

**AUDIT PLANNING FOR VAT RISKS**

To plan for VAT risks, CAEs need to take them in consideration when they reassess their business and control environment and update their risk universe. VAT inherent risks should be assessed and linked with the overall strategic objectives and with the operational business plans. Controls should be evaluated and documented to identify the residual risks.

After conducting the typical risk assessment, a quick comparison between both the previous year and current year heat maps will clearly indicate the impacted functions, processes, and systems where assurance needs to be provided. The scurrying of risks will help the CAE in defining the processes and systems to cover, the scope of audit, and the audit approach.

There are various options on how a VAT audit can be scoped. The VAT preparation project can be covered as a single audit assignment of the entire project. Or, two or more linked areas could be covered together, such as Procurement and Contracts, Commercial and Sales, Account Payable and Sales. The CAE may also decide to audit the VAT readiness indirectly, as part of the regular audit of relevant processes (i.e. sales, finance, procurement, and legal… etc.). However, this approach is not favorable because of the delay in reporting VAT weakness, which could take years depending on the audit cycle.

Audit objectives should focus on ensuring that effective and efficient internal controls are designed and implemented to comply with VAT regulations and to respond to urgent changes without interrupting the business operations.

**DO YOUR HOMEWORK & ASK SMART QUESTIONS**

In order to reach accurate conclusions and to provide valuable reports to shareholders, internal auditors should be able to define the appropriate criteria against the controls to be assessed. That usually goes at the beginning of most of our audit reports as, “What should be happening?”

Given below are some key technical audit criterions that can help in auditing or providing consultancy on the VAT readiness project. Next to each criterion is the rationale to help understand each criterion. It is important to highlight that this table covers the overall process and is not necessarily detailed enough to fit all entities. Auditors should adapt in line with the nature of their business, systems in place, and complexity of transactions.

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**DECEMBER 2017**

**INTERNAL AUDITOR - MIDDLE EAST** 15
<table>
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<th>What should be happening? (Audit Criteria)</th>
<th>What Auditor needs to know (Rational)</th>
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</table>
| 1 | All sources of sales and other revenue should be carefully analyzed and categorized according to the relevant VAT category. Exports should be segregated from local sales. | - Most of the supply of goods and services will be subject to a standard rate of 5%.  
- Some sectors will be subject to zero-rate such as education and basic health care supplies.  
- Few sectors will be exempted, such as residential properties, local passenger transport, and some financial services.  
- Exports will be zero-rated. |
| 2 | Business should register with FTA when they reach the threshold defined by the VAT regulations.       | - Registration threshold is AED 375,000. Threshold should be calculated based on the total taxable sales of the current month, plus the previous 11 months.  
- A Tax Return needs to be submitted on a quarterly basis or less as required by the law. |
| 3 | The impact of risks and opportunities related to VAT implementation should be assessed, and appropriate VAT implementation strategies should be implemented. | - Tax strategy should be designed and optimized according to many factors such as the nature of business, sensitivity of sales to competition, associated risks, business jurisdiction, business relationship with other GCC countries.  
- Holding companies should consider the group registration with FTA. It simplifies the recording of internal transactions and helps in optimizing cash flow. |
| 4 | Procurement plan and commercial strategies should be reviewed and updated to reflect opportunities for cost savings through optimizing the VAT implementation | - It is always recommended to deal only with registered vendors, because only registered entities can provide tax invoice, which is essential to recover any VAT paid.  
- Procurement needs to request for a VAT registration certificate as part of the tender submittal documents.  
- Vendor master files should be updated with the VAT registration numbers. |
| 5 | Legal should review the standard form agreements to ensure the inclusion of the VAT relevant terms to protect the business. | - To avoid any dispute, it is important to update the standard form agreements with the relevant terms to define the party responsible for VAT invoicing, payment, and reporting.  
- Legal should also review and amend all valid contracts signed before implementing VAT where delivery of goods will continue after the 1st of January, 2018. |
| 6 | IT systems and Enterprise Resource Planning solutions (ERP) in place should be reviewed and updated to accommodate VAT requirements. | - IT systems and ERP solutions in place should be assessed to identify the level of customization required to accommodate VAT. This will vary from business to business based on the complexity of the IT architecture in place.  
- Timely and accurate reports need to be generated to be able to fill the Tax Return with the required data. |
| 7 | Business should be able to analyze and accurately calculate the recoverable VAT paid on cost of goods and services.  
A proper mechanism should be defined to precisely identify the recoverable portion of VAT paid on shared expenses. | - Only VAT paid on sectors subject to VAT can be recovered back. Business will bear any VAT paid on exempted sectors.  
- For VAT paid on shared expenses such as marketing and advertising, only the portion paid on sales subject to VAT can be recovered. |
| 8 | Financial policies and procedures need to be updated to address the VAT compliance requirements.           | - Business must keep invoices, accounting records and commercial books, and any tax related information for a minimum of five years. Details of records will be specified by the Executive Regulations of the VAT Procedure Law.  
- Tax Return, data, information, records and documents related to Tax should be submitted to FTA in Arabic only |
| 9 | A compliance framework should be developed to ensure the readiness and accuracy of records and Tax Returns submitted to the Tax Authority. | Depending on the size of the company and the complexity of transactions, a compliance role could be defined to deal with the VAT related issues, ensure compliance with laws and regulations, coordinate with other departments, and follow-up with the FTA. |
| 10 | Proper awareness and training programs should be provided to employees to help them understand and deal with VAT in their day-to-day activities. | The VAT implementation team should possess proven experience in designing, implementing, and testing a VAT implementation process to ensure the timeliness, accuracy and cost effectiveness of implementation. |

**THE WAY FORWARD**

Once VAT has gone live, businesses will be responsible and accountable to comply with VAT regulations by collecting VAT, maintaining accurate accounting records, and filing a tax return on time.

While the level of Internal Audit involvement in the VAT implementation process may vary from business to business and from one CAE to the next, it is foregone conclusion that Internal Audit will have a critical role to play in this changing regulatory and business environment whether that is by providing pro-active and preventive consulting services at the initial implementation phase or by doing post event audits. This role should continue to assure the Board that the business is not paying excessive VAT or incurring fines due to noncompliance with laws and regulations.

Bearing all this in mind, we, as the audit community, must ensure that we train ourselves to grasp the necessary details and nuances of the new VAT regulations and their impact on our duties and responsibility.

**BY: ASHRAF MASADEH, MSC, CIA, CRMA, CF**
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Define internal auditing as ‘independent, objective assurance and consulting activity designed to add value and improve an organization’s operations’. It helps an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control, and governance processes.

In most cases, the internal audit function has substantially changed in recent years from a ‘policeman to an internal consultant, with a governance, and risk focus.’

But with all of the IIA’s efforts, management still sometimes look to internal auditors as policemen, perhaps for the following reasons:

- The attitude of some auditors, who still focus merely on inspection and finding mistakes
- An outdated mentality still present in the governance of some Internal Audit function; an
- Poor education and orientation for new auditors joining their team.

Internal Audit as an Internal Consultant

I believe the Internal Auditor is uniquely placed in any organization to provide practical consulting advice to Management. However, in order to reach that enhanced level of maturity there are a few steps any organization must consider:

1. The Internal Audit function should hold itself out within the organization as an internal consultant;
2. The Internal Audit Charter should have a separate paragraph about the consultation services the Internal Audit function can provide;
3. Internal Auditors should still be truly independent and not influenced by any internal conflicts that might exist;
4. Auditors must be professional and well educated, knowledgeable about the business and come with a proactive and positive attitude;
5. Auditors must develop enhanced negotiation, communication and softer skills to better work alongside the business, as well as developing much deeper technical knowledge about the business itself;
6. Audit teams must be prepared to address risk and provide value-add, practical recommendations;
7. Proper planning must take place in line with IIA standards, and audit scoping should include the ‘big picture,’ analyze processes from end to end instead of focusing on minutiae; and
8. Auditors must at all times keep in mind the Code of Ethics governing such projects, particularly the need to balance consulting with independence.

These points will help the auditor to provide professional consultation to company management, enabling them to trust the quality of work the internal audit team can provide.

Managing the balance

But after all, isn’t Internal Audit an independent assurance function?

To further enhance Internal Audit’s value, the Audit Committee needs to be properly informed about all the consulting services that the Internal Audit Function has provided as part of quarterly reports.

The Audit Committee can then ensure that any consulting services do not compromise the independency of the Internal Audit function, as well ensuring these value-add
activities do not affect the progress of the annual internal audit plan.

Management of the Internal Audit Function must therefore build into the annual internal audit plan time for these value-add consulting services in a way that balances its assurance and consulting roles. This is fundamental at the planning stage to ensure that the Internal Audit Function does not focus on consulting services to the detriment of its core assurance function.

There may also be times when management want Internal Audit to undertake a consultancy assignment but seek some form of assurance that any findings will not be reported upwards or included in Internal Audit’s overall reporting to the Audit Committees. In such cases the assignment should be declined; the circumstances may cause Internal Audit, in its assurance role, to want to investigate the reasons behind such a request in case it is an indicator of a hidden issue. **Being able to undertake consultancy work further adds to Internal Audit’s knowledge base about risk, control and governance and therefore makes a contribution to the overall internal audit opinion.**

**Specialist Skills**

A benefit to any Internal Audit function is that individual internal auditors may have knowledge, experience and skills other than their internal audit skills which management would like to exploit. For instance, internal auditors may also have particular training, experience or qualifications in IT, accountancy or legal issues. If a consultancy assignment is to be delivered in which these skills will be of particular benefit it will, of course, make sense to deploy those internal auditors who have these skills on the assignment. However, it will be necessary to make clear in the agreed Terms of Reference for the assignment that the Internal Audit Function can only be accountable for ensuring due professional care is taken in developing advice offered on risk and control issues. If management choose to place reliance on specialist advice, drawing on skills beyond the internal audit skill set this must be at their own risk - An acceptances by management of advice given to them, of course, involves acceptance by management of accountability for the consequences of implementing the advice; it may be beneficial to note this in the agreed Terms of Reference for the assignment.

When establishing the formal consultancy role and in the strategic planning of the Internal Audit function it will be appropriate to assess the need for consultancy services. Elements of this assessment may include:

1. Consideration of past annual audit opinions; the more general improvement that is required in the organization’s risk, control and governance the higher the need for consultancy activity is likely to be.
2. Consideration of the rate at which the organization and its risk, control and governance is changing. The higher this is, the more need there is likely to be for consultancy services.
3. How much of the consultancy advice being brought in could be satisfactorily and more economically delivered with the Internal Audit skills-set and how much is reliant on different specialist and technical skills.
4. An assessment of management demand. To what extent would management like to request consultancy services from Internal Audit?
5. The capacity of Internal Audit to deliver consultancy services. The consultancy role must not undermine the ability of resources to deliver assurance work and in the short term Internal Audit may have very limited resources for consultancy work. If it is intended to increase Internal Audit’s capacity to deliver consultancy services there will be a lead-time associated with the recruitment of appropriately qualified staff.

It is also important that consultancy services are offered to support management in their work, not to be a substitute for management’s own efforts to address the issue in question. The consultancy role should offer management participative advice and support in their activities. In summarizing, I encourage all Internal Auditors to keep in mind the following when planning to conduct a consultancy assignment:

1. There should be a detailed plan setting out the scope of what is to be reviewed.
2. The objectives should be defined at least in output terms, and ideally in outcome terms.
3. The exact role of the internal auditor should be defined and we should always make it clear that internal audit is not part of any sign-off decision mechanism.
4. Reporting formats should be defined, for example will there be a specific audit report or will the internal auditor’s work contribute to a report generated by a multidisciplinary working group.
5. Timing issues should be defined in detail, including the amount of staff days allocated and targets in terms of elapsed time.
6. Both internal and external quality reviews should encompass an appropriate proportion of consultancy assignments in their review samples.

Finally for more information and guideline about consultancy services you can visit the following link:-

3. https://www.iia.nl/SiteFiles/Publicaties/IIA_Bro_A4_Consulting_Auditing_EN.pdf

AlShareef Marwan H. AlKouli
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Future and Challenges of Family Businesses

Family Businesses have been the traditional way of doing private projects in most countries of the world; and have acquired a great consideration in recent years as one of the means and forms of doing private projects. There are several reasons to attract attention to Family Businesses, including the following:

- The role of socialist systems in political and economic life has diminished in most countries of the world. These systems were not only non-conducive to the growth of private investment, especially Family Businesses, but it has also led to the nationalization of some of these projects in several countries in the world.
- Reducing the role of the public sector in economic life and the growth of the privatization trend led in turn to the entry of multinational companies and some Family Businesses to acquire the public sector companies offered for sale.
- As the country believes in the role played by the Family Businesses in the economic and social development and to find a balance between the foreign companies and the national companies, these countries give incentives to the private companies, including, but not limited to, financing small projects in many developing countries. This encouraged many individuals and families to establish projects.

Before going into the discussion, we would like to agree on the definition of Family Business. Family Business is a company in which family members have effective control over its strategic direction. The Family Business significantly contributes to the income, wealth, name and goodwill of the family. A company can be classified as a Family Business, if it meets all or part of the following requirements:

- Family members effectively contribute to the company's capital.
- Family members have the majority vote in the Board of Directors or the General Meeting.
- Family members have authority or influence on the strategic trend of the company.
- All or some of the family members actively participate in management.
- More than one generation involved in company management.
- Family members' desire or intent to continue as a family business.

In this article, we will not only discuss the specific concept of the family represented in the father, mother and children, but also extends to its broad concept to the brother, sister, cousins, and their spouses ... etc.

Characteristics of Family Businesses, many of which constitute challenges:

1) The strong overlap between the affairs of the family and the company and the absence of separation between ownership and management unlike other companies. This role in turn exposes the Family Businesses to circumstances that may affect them, to the extent that the decisions of management, who are also owners, are not fully subject to the achievement of economic objectives, for example marriage, divorce, death, or graduation of a family member and his desire to work in the company.

2) Family Businesses focus more on long-term sustainability than short-term profits. Most of Family Businesses are managed to maintain, develop and
delivered same to their children and grandchildren in a better position than making big profits by selling them. For instance, a German family from the Bavarian region has an impressive proportion in the German company (BMW), and such family refused several offers from international companies to acquire its share and preferred to retain its ownership of the shares.

3) Most of the time preference will be in the appointment of employees based on personal relationships more than the efficiency, i.e. (Trustworthy persons have priority over skillful and qualified ones). But preference may also extend to giving promotions and opportunities that are available in the company to family members or close persons.

4) Family Businesses may have difficulties in attracting and retaining employees who have special experience or those who occupy leading managerial positions for the following reasons:
   - Family members or their relatives usually hold leading positions.
   - There is often no career path plan for those employees.
   - Low salaries and job benefits if compared to non-family businesses.
   - Family members interfere with the work of competent staff and solely make decisions.

5) Relative difficulty in obtaining finance, as the owners of family businesses are often unable to attract external investors in the company, and the banks don't finance Family Businesses, especially medium or small-sized ones compared to other companies. This, in turn, disables Family Businesses to expand, replace and renew their assets.

6) The Family Businesses’ decisions are severally taken by the founder or owners thereof.

7) Poor Governance System; for example, there is often no clear formal regulatory structure, policies and procedures manual, risk management or internal audit management.

8) There is often no plan to find an alternative or successor to the president / founder upon his retirement or death.

This is one of the most important challenges and problems that are experienced by Family Businesses and may have a fundamental impact on their future course. This problem is not limited to Family Businesses, but it also extends to major global companies. However, this problem is more acute in the Family Businesses for the following reasons:

1- The difference in the method of work and the strategic vision among the different generations in the family between those who lead or manage the company and its successor, while we believe that the difference in the strategic vision and the method of work may have several advantages and may enrich the performance of the company if it is contained and managed in a proper manner.

2- Due to the family ties that exist between the members of the family that owns the company and some of whom are overlapping in the management, the family members do not express their expectations, feelings and need to the chairman of the company or founder fearing conflicting with one of the other members of the family who is close to him and the impact on family relations. This leads to adopt an indirect and informal style of communication among family members.

3- It is difficult to agree on the right person who will succeed the chairman or founder. Several discussions often occur on this subject and may sometimes reach to wrangles. Family members often accept decisions of the founder when he is at the head of the company even if it is inconsistent with those decisions, but the person who heads the company and succeeds the founding president may not enjoy the same advantage, which may create more challenges for subsequent generations of family members who run the company. The problem of choosing the right person from the family, especially when the family is a big one and there are several sons of several wives, may increase, creating more sensitivity in choosing the right person that succeeds the retired president.

4- Inability and reluctance of the founding chairman of the company in the delivery of the leadership of the company to his successor. This is often the case for many reasons, the most important of which is his desire to not lose control over the financial and operating decisions of the company or due to the low income that he will obtain after retirement or he is not convinced of the existence of the right individual to succeed him.

Challenges Experienced by Family Businesses’ Auditors:

1) The auditor’s role as the agent of the shareholders is considered one of the most important roles when the ownership is separated from the management. However, in the Family Businesses as mentioned earlier there is no clear separation between ownership and management, and therefore the project owners do not appreciate the role played by the auditor.

2) The auditor faces more difficulties upon conducting discussion with the management as to the settlement process resulting from his audit, and also if the report is conservative. Moreover, the matter may extend to nonrenewal of the auditor’s appointment, if the auditor insists on the adjustments or his conservative report.

3) The poor internal control system exists in such Family Businesses which management deviates from the internal control systems, if any. This leads the auditor to not rely on internal control systems, which increases the period and cost of audit.

Some suggested recommendations for addressing the challenges:

The existence of the family council encourages and helps all members of the family to deal in a responsible manner with regard to their company without the introduction of non-economic factors in the decisions. The need for the family council increases when the size of the family becomes large, to the extent that it is difficult to communicate and meet with each other and reach decisions.

The International Finance Corporation, a member of the World Bank Group, has defined the Family Council as the body to be elected by the Family Assembly for...
consultation and study of matters related to the Family Business and may also be called “Family Advisory Council” or the Family Executive Committee. The Family Council shall:

- be the primary link between the family and the Board of Directors of the company and the senior management of the company;
- suggest and discuss names of candidates for membership of the Board of Directors;
- determine and review the strategic vision of the company and its mission; and
- determine and review family policy regarding the family members’ employment, and their contribution to the company.

When the Family Council is elected by the Family Assembly, criteria can be set for the elections. For example, there shall be a representative in the Council for each family branch represented by several generations of the family, i.e. the first generation, the second generation and the third generation, and there shall be criteria for electing/not electing those who have a close relationship with family members, and the rules of women and men representation.

The topics that can be discussed and decided by the Family Council, include, but not limited to, the following matters:

- The policy of distributing profits and making balance between the material needs of family members and the financing needs of the company.
- The training needs of family members, especially when they have the ability to act as successor or substitute for the founder.
- The policy related to the purchase and sale of family shares and the valuation method of shares that may be traded among members of the family.
- Discussing and selecting a shortlist of those who have the qualification, experience and ability to lead the company in the future as a successor of the current chairman.
- Discussing and selecting the alternative to the current chairman when he retires.
- Discussing the possibility of creating a fund to support and adopt any ideas or suggestions made by family members regarding their company or related to new investment opportunities for the family.
- Discussing whether the company will continue, be sold or a special or public offering process will be made.

In this regard, it should be clarified that the Family Council is an illegal entity and therefore it is not a substitute for the company’s board of directors, but rather it is complementary to it. As mentioned above, it is the link between the company owners and the company’s board of directors.

The Family Council shall have a President and a Secretary of the Council and shall include up to nine members.

Other proposals to regulate the role of family members and their involvement in management are the preparation of a charter or constitution for the family.

Ivan Lansberg defined the family constitution in Succeeding Generation as “an official charter or book prepared with the cooperation of all members of the family to include the values, beliefs and objectives of the family in relation to their relations with each other and how they deal with the company or companies that they own.”

There are several advantages benefiting the family members and the companies they own, when there is a family constitution, as:

- During the period of preparation of the provisions of the Constitution, all members of the family even those who do not interfere in the management of the company shall be involved.
- This increases communication among them and their sense of belonging to the family and to the company, which has a positive impact on the company.
- The existence of a family constitution helps avoiding disputes among members of the family and preventing the misunderstanding, as it explains the roles of people who are interfering in the management and others who have no right to interfere in the management.
- The existence of a family constitution with the elected Family Council sets the expectations of the second generation and the third generation of family members in its proper framework and governs their intervention in the management as per standards specified in advance.
- The contents of the family constitution are the strategic objectives of the family in relation to their companies, values, beliefs, family mission, family members employment policy, method and rules for nominating a member of the family for leadership positions.
- Method and way of trading shares of the company among members of the family and the basis of evaluation.
- Method of resolving any disputes that may arise among family members.
- Time of accepting an external investor or making a private placement or public offering.

Finally, we discussed the characteristics of the Family Businesses and the challenges they face. Then we addressed the challenges facing the auditors of these companies and then presented some suggestions to overcome the challenges experienced by the Family Businesses to ensure long term sustainability of these types of companies because they have a positive impact on the economic and social life of the country.

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Business excellence powered by innovation and experience
Over the last few years, technological developments have begun to accelerate if compared to previous decades, and their impact on the distant future may be far greater than currently expected. We have begun to see unmanned vehicles based on artificial intelligence, aircraft vehicles, high-speed trains, 3D printing and self-operated factories without human intervention, as they wholly rely on robot. These developments, if continued in this form and developed further in the future, will result in a large decline in labor force and a decline in the proportion of jobs in general and these developments may lead to a decrease in accident and mortality rates which will be reflected directly on the demand for other sectors such as insurance and health sectors, which means fewer workforce in these sectors. Non-traditional laws, policies and procedures may also be introduced that may limit the demand for the future internal audit profession. In this article, let us anticipate events and take a look at the challenges that may face the internal audit profession in the future.

The technological developments have been adopted and welcomed by companies, institutions and operators in various pivotal sectors that have a fundamental impact on all aspects and patterns of life such as aviation, transportation, energy and industry. It is worth noting that the resistance to forms of change has fallen to low levels, and same has changed many concepts and methods of corporate management in line with the aspirations of the future. In this regard, the internal audit should play a role that meets the expectations and is in line with the rapid developments. However, there are many challenges that the internal audit has to understand and set development plans to confront them from this moment until the internal audit plays a positive role and until the profession progresses in line with the expected developments. These challenges are:
Think outside the traditional box

Due to the differences in business environments and more reliance on artificial intelligence and speed of decision-making, the independence of internal auditing may be one of the obstacles that keep internal audit away from the decision-making process. Advising senior management may be the biggest role in the future that relies on speed of decision-making, analysis of major data, and self-decision making by technical systems, and there may be significant development in networking between companies, banks and different governments and competition may depend on who has more information, all this requires the internal audit to think differently outside the traditional box and think in a way that will sustain business.

Change of Business Models

Perhaps the biggest challenge for internal audit is to change corporate business models. In the future, we may see automated systems that have the ability to make decisions that affect the business model adopted by the company, and we are likely to see a different risk management culture than what is commonly adopted, and the culture of acceptance of risk may become more common than the current in the light of intense competition and an environment of rapid decision-making. This challenge requires internal audit to keep abreast of developments and develop the profession in line with advanced business models.

Availability of Competencies and Skills

A technology-based future requires skills that depend on technology and professionalism. Engineers and programmers may be the majority of internal auditors. Data analysis skills and industrial behavior analysis skills are a prerequisite for future auditors. These changes may make the selection of internal auditors a challenge for internal audit departments that wish to employ qualified auditors.

Building an Internal Audit Plan

Building an internal audit plan is a key challenge in the future. The complexity of the technology-based business environment makes it difficult to define the universe and the scope of audit, and the current risk assessment method may need to be developed, as the accelerated developments of the future business environment may render the emerging and strategic risks on which the process of building the internal audit plan relies.

Reliance on Automated Systems

The lack of intervention by the human factor in the event that technology controls the business of companies in the future may make the factor of judgment and diligence of the internal auditors more difficult. Will we see a robot internal auditor in the future? This may be a challenge in itself.

Communicate Audit Results

One of the challenges that internal audit may face is the change of traditional communication methods from what is currently known, most of which rely only on reporting. This challenge requires auditors to have sophisticated communication skills and methods based on fast access to results and rapid reporting.

In the end, the Institute of Internal Auditors must take such challenges into account to develop the internal audit profession so as to ensure the sustainability of the profession and to reserve a suitable place in the future, especially that there are many professions and jobs will disappear or change significantly in the future and I think the internal audit profession will be one of these professions that will change and take a new shape that may be quite different from the current one.

Sami Abuzeina
UAE IAA offers the following Quality Assurance Services

**Readiness Review**
- Conduct an independent gap analysis focused on the internal audit activity’s current level of conformance with the Standards;
- Recommend actions for remediation of identified gaps to the IPPF;
- Identify opportunities to improve efficiency and effectiveness of IA processes

**Self-Assessment with Independent Validation (SAIV)**
- Self-assessment by the internal audit activity
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**External Quality Assessment**
- Assess how well the IA activities conform to the International Standards for the Professional Practice of Internal Auditing (Standards);
- Evaluate the performance of the IA department and substantiates the expectations of the board and executive management;
- Identify opportunities to improve efficiency and effectiveness of IA processes

**Advantages of Quality Assessments**
- Raise awareness of IA professional standards amongst management
- Identify areas for improvement
- Full conformance with the IIA Standards
- Bring systematic, disciplined internal audit approach
- Increase credibility within the organization
- Anticipate, meet or exceed stakeholders expectations
- Benchmark IA practices
Fraud Risk

Tips to Avoid Fraud in Small Enterprises

According to the results of the study which was prepared by the Association of Certified Fraud Examiners ("ACFE") and issued in 2014, enterprises with fewer than 100 employees were more likely to have fraud cases reported to the ACFE. The total losses from fraud in large enterprises were slightly higher than the total losses of small enterprises as shown in the following diagram:

![Diagram showing size of victim organization frequency and median loss]

According to the ACFE’s studies, the most common types of fraud include:

- Theft of cash;
- Claiming fictitious charges; and
- Theft of assets.

The main reason for thefts in small and medium-sized enterprises is due to the employees by themselves, as, by virtue of the nature of their work, the trust among employees increases and the control and accounting factor becomes weaker on the basis that they are members of a single family.

What makes enterprises vulnerable to fraud?

There are many factors that help make enterprises vulnerable to fraud, including but not limited to:

- Lack of adopted policies and procedures that leads to opportunities for fraud.
- The same employee performs several tasks, which helps them hide their illegal activities.
- Over time, employees become like a single family and controls over their activities become lesser due to trust.
- Lack of awareness and experience of staff in detecting fraud.

How can enterprises get help to overcome this phenomenon?

Internal auditors are responsible for informing their clients about the risks of fraud and how to avoid them and mitigate their effect in order to avoid losses arising therefrom.

The following are the top 9 points to be discussed with management in SMEs:

1. **Accounting duties and cash transactions shall not be assigned to one employee:**

   For the small size of enterprises and few transactions carried out therein, only one employee is usually assigned to register the accounting transactions, receive cash from customers, deposit same in banks and make transfers among the various accounts of the enterprise. Assigning one person to perform these duties increases the possibility of fraud or theft, and the management cannot easily detect such theft or fraud. It is therefore recommended that there should be at least two different people, one of whom shall be assigned to register while the other person shall be assigned to withdraw, deposit and transfer.

   If the cost of employing more than one person to perform these tasks is high for the enterprise, it may be advisable to contract with an independent accounting office to carry out accounting transactions on behalf of the enterprise, ensuring proper segregation of duties.

2. **Ensuring that staff is well known to the Management:**

   Because of the small size of the enterprise, the few number of staff who has existed since the establishment of the enterprise for a period that may extend for several years, the employer may feel embarrassed over time to investigate the information and facts about his staff, and may easily appoint some employees who have relations with current employees that are trusted by him. It is worth noting the all employees’ circumstances, previous history in work and daily life shall be well known. With little time and effort in performing background check of employees, the enterprise may save a lot of money that could be wasted in case of any fraud.
3. **Ensuring that an adequate internal control system exists:**
Regardless of the size of the enterprise, the management shall set effective controls to reduce the risks of fraud such as:

- Set controls over access to financial statements and accounts.
- Set controls over access to warehouses in order to avoid theft and help identify any deficiencies and persons involved.
- Emphasize the need to adopt all major financial transactions by two different people such as:
  - Payment of expenses;
  - Signing of cheques; and
  - Payment of employees' salaries and benefits and other accounting activities.
- Use audit trail to track transactions.

4. **Continuous monitoring of bank accounts:**
In comparison to all steps taken to prevent and detect fraud attempts, this is the easiest method in implementation. Currently, most banks offer highly secured and confidential online banking service, allowing the enterprise to track and monitor accounts anywhere, anytime. This step helps giving the management an accurate idea about all transactions performed on the enterprise's accounts and the possibility of identifying any attempts to manipulate the deposited or withdrawn balances or amounts.

The following items shall be highly considered:
- Loss of certain cheques numbers or their numbers are not in serial.
- Receive transfers from unknown entities.
- Transfer of funds to enterprises or unknown persons (not related to the enterprise).

Informing staff that the management has controls to keep track of enterprise accounts will significantly help reducing the attempts of fraud and theft.

5. **Continuously review high-risk areas:**
Management should continually review and audit high-risk areas. The main areas to be monitored include:
- Cash;
- Inventory management system; and
- Accounting transactions.

The management should inform employees that the business will be audited and reviewed, without informing them of its timing. Random checks help detecting fraudulent attempts or frauds.

Therefore, specialized consulting firms could be hired to carry out such audit and review.

6. **Train the staff to prevent fraud:**
It is important that the enterprise's employees, especially those in departments that are most vulnerable to fraudulent attempts, shall be aware of the following:
- Identification of frauds
- Methods of preventing frauds

- Reporting suspicious cases either from their colleagues or from clients

It is recommended that enterprises train and educate staff how to identify fraud red flags. Moreover, it is also recommended that a whistleblowing system should be established in case staff has any doubts about fraudulent transactions. So that the reporting person is not identified to maintain his privacy and to encourage him to report any doubts he may have.

enterprises should also develop a corporate code of ethics that clarifies that frauds are illegal and therefore anyone who carries out this type of activities will be held accountable.

7. **Protecting the enterprise's credit card data:**
This step may seem obvious, but it is important to protect sensitive information and data such as the enterprise's credit card numbers and not to mix them with accounts and personal cards. Using personal and enterprise's accounts at the same time may lead to confusion among accounts and give a chance for fraud and manipulation.

Opening enterprise's accounts and performing financial transactions through secure and reliable websites increases security measures and reduces the chances of electronic fraud.

8. **Identify stakeholders:**
It is recommended that enterprises shall create a database of key stakeholders (key customers and suppliers). This data should include:
- Official registered address;
- Contact name, phone numbers and mailing address; and
- Information of entities that have dealt with these stakeholders.

For further verification, the enterprise should answer the following questions:
- Has the enterprise ensured that the stakeholders' operations are legitimate;
- Are the details of the stakeholders' senior management available; and
- When the stakeholders' enterprises were established and how many years of experience in their field of work.

9. **Hiring independent experts:**
In addition to the above, the enterprise may need further assistance and support in applying the necessary control procedures. It is recommended that an independent fraud expert may be hired to establish the bases and rules. At the same time, the auditor should carry out more thorough and comprehensive audit procedures to verify the accuracy of the financial statements.

**Conclusion:**
Owners of small and medium-sized enterprises underestimate the risks of fraud, believing that they are protected. However, all studies show that these enterprises are at risk of fraud. Owners of these enterprises may feel it is shameful to discuss methods and steps to avoid and detect fraud. In this regard, internal auditor should increase awareness of fraud risks.

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Social media today… A large consultancy publishes a report regarding internal audit – sharks sense blood, and start circling around the profession. They have even prepared their writings for our gravestone as a profession, it seems. And everyone has the solution for “fixing” internal audit. There is a catch, though, they will charge you for the problem they believe you have. But are we really done as a profession? Are we even in a crisis? There is, after all, a global internal audit body that can measure these metrics for us. And it would not charge us for it. As all professions, we evolve, we adapt, but we are far from over.

A wise man once told me – follow the money. Who has what to gain by what is going on now? What is the motive in this triangle? I would not go as far to call it the fraud triangle, but someone is hoping to cash in on it…

Bear with me for the next three paragraphs, I will depart from this discussion to make a point.

I remember a published article which stated that there is no connection between the vaccinations, and autism in children. The article was used to promote vaccination and debunk the fears over the practice. As I know people whose children have developed autism following the vaccine in question. I decided to click on the link and read the full report. It was a long report, but I had the spare time, and read it through. Near the bottom – an objectivity/conflict of interest statement. “The doctors x,y and z work for the ABC pharmaceutical company”.

Hmm… Interesting, I thought to myself. Let me google this company. ABC is owned by DEF. Let’s google DEF… Turns out they have paid hundreds of millions of dollars to settle out of court and close various claims and legal suits against them. Cases for misleading the public right there in the media.

So, I think to myself: “Would I trust this company, with its history?”, DEF has everything to gain by a positive report, and the professionals doing the report are on their payroll (via ABC, smart move). They have been fined for misleading the public already. Has anything changed now? What about the people I know, who suffer the consequences? Why would they lie to me? And what are they for DEF? A statistical error somewhere in the data, probably. But even if 1% suffer, does that make it...
ethical? Does a corporation equal God? Can a corporation decide to negatively impact the lives of thousands, as their medicine is "good enough"? What about the doctor that prescribed chemotherapy for people who did not have cancer? He benefited financially from ruining lives. And people trust doctors by default... And consultants...

Back to our Apocalypse... Like I said, in the age of social media, click baiting seems to be everything. Sensational news sell, and suddenly everyone is an expert. And no one listens to the actual voice of the profession, the IIA.

So, let us say, for the sake of argument, that a corporation has just paid billions of dollars to settle out of court. Imagine there was an article in the news about it recently. And imagine they tell you, your profession is declining, is in danger, and they can help you out. Use their "magic pill", the solutions you would be charged for.

You can grab the bait... Or, you can listen to what the profession has to say about it. Read IIA reports, publications, blogs, network on conferences, obtain insights from your colleagues, from your own experience. Leave your cave, and interact with the stakeholders. What keeps them up at night? What do they need our help with? Be the water-cooler internal auditor and mingle with employees to feel their pulse, understand their fears.

I am not saying our profession is perfect, far from it. But is external audit perfect? Were there not a number of scandals in the past? What is the level of satisfaction of their clients? I can only assume very high, as companies are paying for the report, and I have yet to see a negative external audit report. Oh, the things I’ve seen. But that is a different topic altogether, I shall tackle those ethics some other time.

I am now a consultant. I have crossed the river to the other side, I have so far criticized in this article. But one thing I would never dream of doing, is inventing a problem for a client, in order for me to fix it for them. While internal auditors should strive to become a trusted advisor – and tell that to the manager who missed a promotion, or was penalized, or lost a job due to some of our disclosures, you would probably find his opinion in a poll somewhere – so should the consultants. If you want me to hire you, you’d better be level with me. And do a research for a subject which cannot bring you extra revenue, or expand a market. If you cannot do that, at least hire the IIA to validate the research you have done for their profession. You owe us that much, after all, you are offering internal audit services to clients yourselves.

As for internal auditors, we have a lot of work to do:
- From educating boards, managers, and more importantly students on what internal audit is. If you expect a healthy skin from a spinal surgeon, you cannot blame him for your expectation gap.
- Educating human resource professionals and recruiters – how many vacancies are out there, where the internal auditor is expected to be a CPA or ACCA? How many organizational charts where the internal audit reports to the CFO? Is there even a requirement for the candidate to be a member of the IIA? Would you hire a lawyer who is not part of the legal chamber?
- Educating politicians and legislation bodies – how many laws are out there for internal audit which completely disregard the IIA, and even promote external auditors for internal audit positions? I am talking developing markets here, countries where the profession is relatively new.
- Educating internal auditors – mingle with your clients. Get to know what they feel, establish a relationship. You are not a police officer who is there to put them in jail.
- Rigorously enforce the code of ethics – there are bad apples, for sure. I have witnessed a few of them in action.

But, do not despair, no need to be discouraged. It is a natural evolution of a profession. Frankly, if someone asks me, we are doing a tremendous job. We are juggling assignments, managing expectations, investigating frauds, helping companies improve their processes, management of risks, governance, and saving a lot of money while we are at it. While managing our relations with the clients, I may add. By definition, people do not like being audited. Unlike external auditors, we do not do a "hit and run" once a year, but we stay here and face the fallout from our work, in terms of relations. Are we pressured to alter findings? – Yes! Of course. It is in the nature of our work. Some people even criticized the profession over this online. We are not the ones doing the pressuring. What we do is we stand our ground. And if we lose our job over it, so be it. You can get a new job, you cannot get your integrity back.

By definition, an internal auditor is someone who prefers to work in the background, and someone that digs into those papers, contracts or documents that no one wants to read. An internal auditor would not be the one to brag his achievements, so we are mostly left with this skewed perception of reality, that our profession is in danger, or that it is not doing a good job. Mostly from external sources.

That does not mean we do not have our "battle" stories to tell. Maybe we effected savings that cover the internal audit budget for the next 100 years or so. Maybe we detected some major fraudulent practices. Maybe we alerted the board on some critical risks that later turned out exactly like we predicted. Maybe we helped implement a major new improvement via our consulting engagements. The IIA might do well to think of a way to highlight some of the tremendous achievements our colleagues are doing.

Looking forward to your comments.

Slobodan Dimitrovski

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