
# KEY AUDIT AND BUSINESS RISKS - START UPS BRACING TO BE A $1BN UNICORN (Vs KEY BUSINESS RISKS)

Unicorn — the elusive mythical creature that has become a buzzword within the global startup landscape and with a good reason! A Unicorn is a privately held startup company valued at over $1 billion. The term was coined by venture capital investor Aileen Lee in 2013 to describe rare tech startups that were valued at more than $1 billion.

Key success stories in Dubai include Careem (acquired by Uber) and Souq.com (acquired by Amazon). An entry into the unicorn club validates a startup's business model by giving it the much-desired stamp of success and underlines its value proposition in the eyes of investors. A unicorn's brand grows in both visibility and operational outlay, which leads directly to greater business opportunities. No wonder then, almost every upcoming startup and entrepreneur today aspires to gain an entry into the prestigious Unicorn club.

Key factors behind the growth and success of a Unicorn include the disruptive impact it has on its chosen market. It is equally important for startups to add value for all key stakeholders in the entire business chain. Something that external lenders are reliant on, when an exit clause is exercised. Once a startup starts gaining traction in the market, growth becomes inevitable.

Several startups in the GCC, including the UAE, are bracing to become Unicorns. The ten best funded tech startup firms in UAE since 2015 are in the e-commerce space, which is a vital contributor to economic growth and attracts investor money.

Financial Service organisations need to be mindful of various risks associated with Unicorns considering their interfaces with Unicorns (or wannabe Unicorns).

As part of our commitment in helping bridge the expectations gap, Crowe UAE highlights key business and audit risks pertaining to Unicorns using the Audit Risk Model while focused on key Business risks. A tool used by auditors to understand the relationship between various risks arising from an audit engagement enabling them to manage the overall risk. Audit risks model suggests that the overall audit risk of an engagement is the product of the following three component risks i.e. Inherent Risk, Control Risk and Detection Risk.

### Thought leadership: Our own analysis

**1. What Audit Risks come to mind from reading the above?**

a) Inherent risk for Unicorns- Risks at the Assertion level impact transactions, balances, disclosures. Factors to be considered by the Credit Risk teams;

   i. Valuation Risk – Risk of over or under valuation.

   ii. Compliance with Reporting Standards – Presentation & Classification of debt & equity instruments.

   iii. IT Security risk – Breaches and the threat of cyberattacks.

   iv. Many are audited for the first time – less understanding of the environment.

b) Control risk Key Questions to consider before investing or lending money.

   i. Do they have a proper oversight by an independent committee?

   ii. Do they have a proper internal audit function?

   iii. Policy & Procedure compliance – Start ups may not have established policies and procedures.

   iv. Can the system of Internal Controls keep pace with expected change (to be a Unicorn)?

   v. Have the IT Governance systems in place, been tested independently?

c) Detection Risk Key areas from an Auditor's perspective.

   i. Sampling: How does the auditor ensure the sample represents, the population fairly ?

   ii. Materiality: What factors has the auditor considered when setting performance materiality?

   iii. Audit conclusion: How has the Auditor gathered sufficient and appropriate audit evidence?

   iv. Audit Approach: Has the Auditor adopted the audit approach and methodology appropriately?

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Food for thought… If the auditor assumes the inherent risk and control risk to be 60% each, then the detection risk has to be set at 27.8% to prevent the audit risk to be not exceeding 10% (if 10% is auditor's acceptable audit risk).

**Question:** What calculations did the Auditor use to arrive at the conclusion that the detection risk is set at 27.8%?

**Answer:**

AR(Audit Risk) = IR (Inherent Risk) x CR(Control Risk)

x DR(Detection Risk)

DR = AR/ IRxCR

=0.10/ 0.6x0.6

=0.278 i.e. 27.8%

**2. What does your Audit engagement team do to mitigate the Audit risks?**

a) Spend more time on planning – Timing including interim procedures, right mix of resources, use of technology, meetings with business / non-finance team etc. Involve a subject matter expert (SME) at the planning stage to assist the team for it to get good insights about the business and industry and ensure that procedures are designed adequately to address the risks

b) Adapt the audit procedures based on the identified significant risks to reduce audit risk to an acceptable level.

c) Obtain sufficient understanding of the internal control environment and perform tests of the internal controls

d) Effective use of Big Data – assists the Auditors to analyse critical data.

e) Read the contractual arrangements with investors and lenders to ensure terms are appropriately disclosed in the financial statements.

f) Specific procedures apply to test areas related to audit risks including those involving significant judgement.

g) Design audit programs to obtain evidence necessary to form conclusions at assertion level, leading to opinion on the financial statements.

**3. What is a Business Risk and name key business risks coming to mind?**

Business Risks are those risks that could adversely affect entity's ability to achieve its objectives. Business risk may, within limits, influence the auditor's assessment of the acceptable level of audit risk. Key Business risks include:

a) Variable margins – A slight change in costs may lead to profit erosion.

b) Debt Servicing Risk – Focus on the business model not debt servicing.

c) Utilization of funding for expansion beyond UAE.

d) Could there be a trade-off between excessive costs and insufficient benefit?

**Message from the International Liaison Partner(ILP)**

We live in an environment where more and more startup ventures quickly attract large amounts of investor equity or external debt. Whilst this signifies the growing important not only of Dubai as a regional startup hub, it also means Auditors are tasked with an even greater expectation to play an active role in driving up the quality of Financial Reporting. At Crowe, we consider ourselves a Challenger firm and are working closely with regulators and stakeholders to promote a culture of improvement. The first of this series looks at Key Audit Risks-something that key stakeholders such as Banks or Investors, need to be aware of before they place reliance on Audited Financial Statements for making key decisions or investment decisions.


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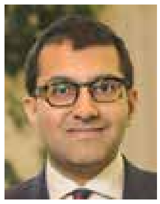

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## About Us

Your global partner

Crowe is ranked as the 8th largest accountancy network with globally more than 42,000 partners and people in over 130 countries.

We share a common purpose of building value for clients through international business. Still placing great emphasis on establishing long-term relations with each of our clients. This enables to work together in an atmosphere of openness and trust. Simply stated, it is how we live our core values – care, share, invest and grow.

The firm continually demonstrates a commitment to quality while serving clients through our international expertise and talent. Our commitment to the highest technical standards and integrity, ensures that our clients receive the most accurate and relevant advice.

We provide professional services by leveraging through extensive local experience and high level of partner involvement. Our aim to provide due diligence with care has enabled us to serve a diverse range of clients ranging from small family owned businesses to large multinational conglomerates.