



金融監督管理委員會
Financial Supervisory Commission

2014 CPA Firms Inspection

General Inspection Report

Financial Supervisory Commission, Taiwan

June 2015

This is an English translation version of the original Traditional Chinese text. In the event of any inconsistency between this translation and the original text, the latter version shall prevail for all purposes.

I. Introduction

Article 19 of the Certified Public Accountant (CPA) Act provides as follows: "In order to safeguard the interests of the general public and promote the good of society, the competent authority may dispatch personnel to inspect the operations and operations-related financial status of a CPA firm that has been approved to provide attestation services to public companies. A CPA firm may not avoid, impede, or refuse to cooperate with such an inspection." The purpose of the inspection is to ensure high quality audits, to enhance the internal quality control of CPA firms, and reduce the potential risk of audit failure. By evaluating the work performed by auditors and promoting high quality auditing, the FSC is aiming to raise public confidence in the audit opinions of accountants and financial reporting, and it has no punitive intent.

II. Domestic CPAs and CPA Firms:

(I) As of the end of May 2015, the number of CPAs and the distribution of types of CPA firms and practicing CPAs:

Status of CPAs	Num.	%
Approved to conduct auditing and attesting business for the financial reports of public companies	758	11.3
Registered as a practicing CPA with competent authority	3,654	54.3
Holds CPA certificate but does not practice as a CPA	3,078	45.7
Hold CPA certificate	6,732	100

Single-person CPA firm		Joint CPA firm		Co-location CPA firm		Total
Num.	%	Num.	%	Num.	%	
1,483	77%	384	20%	52	3%	1,919

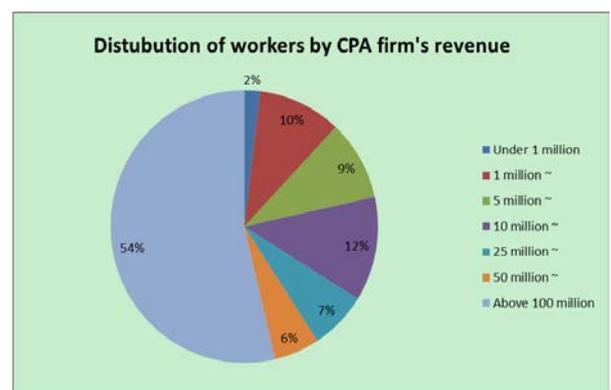
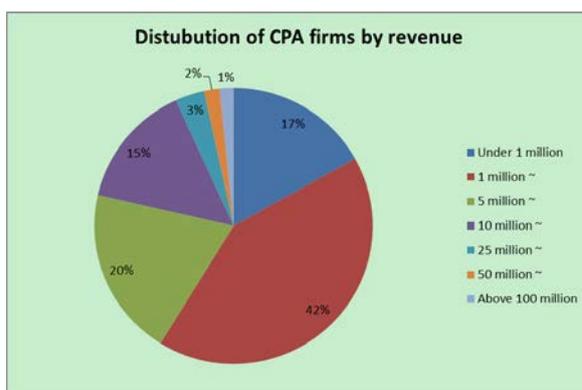
Registered as a practicing CPA with competent authority	Big four* audit firms	Mid-tier audit firms
Approved to conduct auditing and attesting business for the financial reports of public companies	324	434
Not approved to conduct auditing and attesting business for the financial reports of public companies	23	2,873

* Big four audit firms are Deloitte 、 PWC 、 KPMG and Ernst & Young.

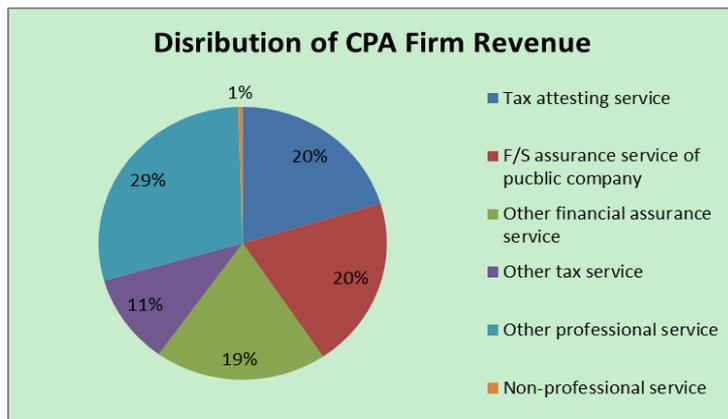
(II) According to the latest Annual Survey of the CPA Industry of Taiwan, revenue statistics from the 1,042 CPA firms up to the end of 2013:

1. The scale of CPA firm revenue:

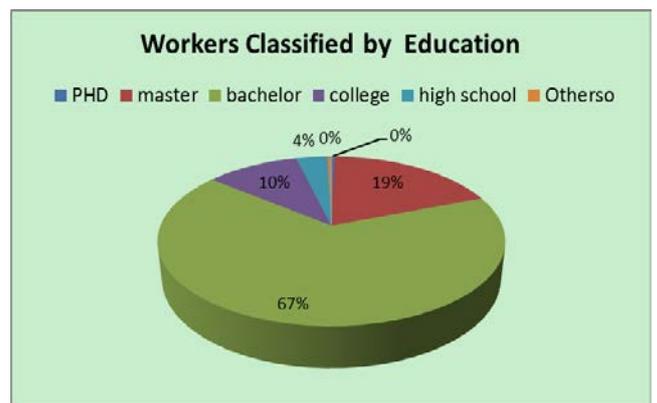
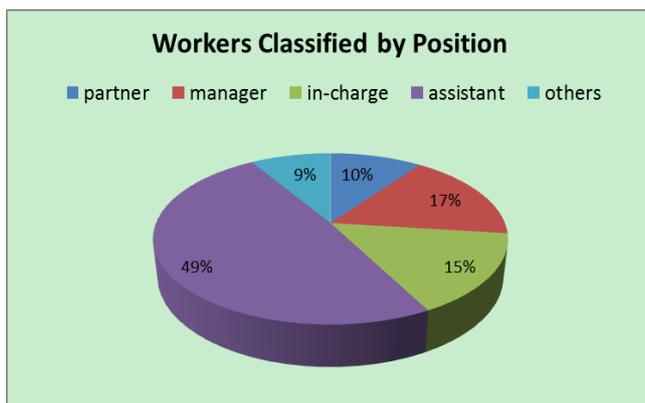
Revenue range	Num. of CPA firms		Num. of Workers		2013 Revenue	
	Firm Num.	%	Workers Num.	%	Revenue (thousand)	%
Total	1,042	100	20,054	100	27,408,275	100
Under 1 million	176	16.9	371	1.9	74,373	0.3
1 million ~	437	41.9	2,041	10.1	1,216,944	4.5
5 million ~	206	19.8	1,897	9.5	1,479,147	5.4
10 million ~	152	14.6	2,479	12.4	2,214,480	8.1
25 million ~	35	3.4	1,381	6.9	1,266,081	4.6
50 million ~	19	1.8	1,108	5.5	1,272,879	4.6
Above 100 million	17	1.6	10,777	53.7	19,884,371	72.5



2. The type of the CPA firm revenue: According to the Annual Survey of the CPA Industry, the major part of firm revenue was professional service revenue in 2013(99.5%), and non-professional service was only 0.5%. In professional service revenue, the tax attesting service, the financial report assurance service for a public company, other financial assurance service, other tax service and other professional service accounted for 20.3%, 20.3%, 19.3%, 10.7%, and 28.9% , respectively.



3. Personnel in CPA industry: There were 20,054 workers in the 1,042 CPA firms surveyed. The workers classified by position were assistant, manager, in-charge, partner, and others (49%, 17%, 15%, 10% and 9%, respectively); the workers classified by education mainly had bachelor, master, and college-level educations (67%, 19%, and 10%, respectively).



III. Inspection Findings:

(I) Inspection Principle, Focal Points, and Methodology

1. Inspection Principle: The FSC carries out audit firm inspection with a risk-based approach in terms of inspected firm and audit engagement selection. Through reviewing the work performed by auditors, the FSC requires that audit firms take necessary remedial measures to address any deficiencies found during the inspection. The FSC also provides recommendations for audit firms to improve their internal quality control system to better comply with regulations and generally accepted auditing standards (GAAS) with the aim of enhancing audit quality.
2. Focal Points of Inspections:
 - (1) Review of Quality Control System: Inspectors review firm policies, procedures, and audit engagements to assess whether the audit firm's quality control system is carried out in accordance with the requirements of the Taiwan Statement of Auditing Standards No. 46 "Quality Control for Firms" ("SAS No. 46" hereafter). The specific areas of the quality control system that inspection procedures address include the following:
 - A. Leadership responsibility for quality control within the firm (Tone at the top)
 - B. Independence
 - C. Client acceptance and continuance (risk management mechanism)
 - D. Human resources (partner evaluation, compensation, admission, assignment of engagement team, and continuing professional training)
 - E. Engagement performance (engagement quality control review, consultation, and disagreement)
 - F. Monitoring (the firm's internal inspection program, communications, corrective actions, and follow-up of on identified deficiencies)

(2) Review of Individual Audit Engagements:

- A. Inspection focus and selection of audit engagements are planned annually with a risk-based approach.
- B. Audit engagements are selected considering public interest, materiality, and other risk factors by the FSC without influence from or limitation by the inspected firm.

3. Inspection Methodology

(1) Review of Quality Control System

- A. Understand the CPA firm's quality control policies and procedures through interviews and related documents.
- B. Evaluate the design of the inspected CPA firm's internal quality control system.
- C. Conduct appropriate compliance tests to assess the effectiveness of the quality control system.

(2) Review of Individual Audit Engagements

- A. Interview the engagement partner and the engagement team manager to understand the risk assessment, audit focus, and audit method.
- B. Review the working papers to examine whether the audit is in conformity with the "Regulations Governing Auditing and Attestation of Financial Statements by CPAs" and the Taiwan SAS.
- C. Assess the effectiveness of the firm's quality control system through the findings of the individual audit engagement review.

(II) Limitations of the Inspection Results:

- 1. Due to various factors (e.g. firm size, business model, nature of its clientele, and risk management strategies), different firms adopt different policies and procedures to comply with relevant laws and regulations and fulfill professional responsibilities.

2. This FSC general inspection report should not be regarded as an endorsement of a CPA's audit, nor should it be regarded as assurance that audited financial statements are free of any deficiencies, even if there was no deficiency noted in the inspection report.

(III) Inspection Findings in 2014:

In 2014, the Financial Supervisory Commission (FSC) conducted inspections on three CPA firms. The findings are:

1. Review of Individual Audit Engagements:

(1) The working papers did not contain the following audit procedures as required under Article 22 and 23 of the "Regulations Governing Auditing and Attestation of Financial Statements by Certified Public Accountants" (referred to as "the Regulations" hereinafter):

- A. The review procedures of the confirmation sent by network firm in another area.
- B. The professional judgments that support the assessed materiality for the financial statements as a whole.
- C. Audit sampling.
- D. Asset impairment.
- E. The following steps to deal with the deficiencies of the control procedures about information accessibility.
- F. The audit trail of the effectiveness of internal control.
- G. Evaluation of the liquidity of investment of bonds.
- H. The reasons of the inventory item that was planned to be checked but wasn't checked.
- I. The auditor failed to file the final financial report of the equity investments audited by the other CPAs into the working papers, nor did the auditor state the invested company's draft financial statements were used to recognize investment gain/loss and prepare consolidated financial

statements in the working papers.

- (2) According to Article 32 of Taiwan SAS No.43 "Consideration of Fraud in a Financial Statement Audit" (referred to as "SAS No.43" hereinafter), the auditor should make inquiries of management and others within the entity to obtain their views about the risks of fraud and how they are addressed. It is found that the firm only made inquiries of the accounting officer and the internal auditor.
- (3) When performing confirmation of bank savings, the auditor failed to adequately document the audit trail showing the sending record, the confirmation control sheet and the summary of confirmation responses. The auditor violated Article 29 of Taiwan SAS No. 38 "External Confirmations".
- (4) The auditor failed to properly conduct adequate audit procedures of sales revenue, according to Article 20, subparagraph 1.3 of the Regulations:
 - A. When performing the substantive test, the auditor did not verify whether the accounts receivable were offset against the same parties to which the sales were made.
 - B. The auditor only checked supporting source documents from the audited entity but outsiders when doing the walkthrough test of sales revenue.
 - C. The working paper did not contain appropriate assessment about the audit reasonableness of the timing of sales revenue recognition.
- (5) Failed to execute the audit plan appropriately
 - A. The engagement partner did not sign the date on the working paper of the audit plan, so it cannot be confirmed that the audit plan was reviewed before it was executed. The firm violated Article 29 of Taiwan SAS No.47 "Planning an Audit of Financial Statements".
 - B. Auditor only determined materiality for the financial

statements as a whole, but did not determine performance materiality for purposes of assessing the risks of material misstatement. In addition, auditor did not document the risk assessment of material misstatement level for identified account balances. Thus, the firm violated Article 10 of Taiwan SAS No.51 “Materiality in Planning and Performing an Audit” and Article 24 of Taiwan SAS No.48 “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment” (referred to as “SAS No.48” hereinafter).

- C. The auditor did not determine whether information obtained in prior periods remained relevant when the control environment of the audited entity had changed, nor did the auditor obtain an understanding of the characteristics of manual elements and automated elements of the entity’s internal control relevant to the auditor’s risk assessment, as required under Article 44 and 81 of SAS No.48.
 - D. The auditor failed to consider that there is a risk of material misstatement due to fraud related to revenue recognition when planning an audit of financial statements, and the auditor did not assess appropriately the risk of material misstatement due to fraud related to revenue recognition, as required under Article 102 of SAS No.43.
 - E. The auditor failed to design the nature, timing and extent of further audit procedures according to an understanding of internal control of the entity, as required under Article 71 of SAS No.48.
- (6) The auditor did not assess the system of internal controls and did not review relevant documentation when performing audit procedures of financial assets, as required under Article 20, subparagraph 1.2 of the Regulations.
- (7) The working paper did not contain the plan of observation of inventory counting, and the auditor did not send a confirmation of the items held for other parties, as required under Article 4

and 12 of SAS No.9 “Physical Inventory Observation”.

2. **Review of the Quality Control System:** In review of firm audit quality system and processes, inspectors observed that the following deficiencies need to be addressed:

- (1) **Leadership responsibility for quality control within the firm**

- A. The firm failed to establish the performance evaluation criteria that give consideration to the responsibility of personnel for the firm’s quality control system. The firm also failed to establish a partner evaluation system. These deficiencies constituted violations of Article 11 of SAS No.46.
- B. The firm did not establish policies and procedures that emphasize the firm’s quality control system, and failed to incorporate quality control system in the firm’s training materials, as required under Article 59 of SAS No.46.

- (2) **Ethical Requirements**

- A. The policy about the rotation of the engagement partner violates Article 68 of SAS No.46 and the Interpretation issued by the ARDF (Taiwan’s accounting standards setting organization).
- B. The firm had no policies to communicate its independence requirements to its personnel except obtaining written confirmation of compliance with its policies on independence. The firm did not comply with Article 16 of SAS No.46.
- C. The firm failed to set out criteria to reduce the familiarity threat, and did not rotate the senior personnel, as required under Article 20 and 46 of SAS No.46.
- D. The firm failed to establish appropriate procedures when breaches of independence requirements were identified, as required under Article 18 of SAS No.46.

- (3) **Client acceptance and continuance**

- A. The successor CPA accepted an engagement with a new client prior to obtaining the reply information from the former CPA, in breach of Article 5 of SAS No.17.
- B. The firm did not establish policies and procedures for the acceptance and continuance of client engagements regarding obtaining such information from the former CPA, considering whether the firm has the competence, capabilities, and resources to undertake a new engagement, as required under Article 21 and 22 of SAS No.46.

(4) Human resources

- A. The firm did not have policies and procedures related to human resources including recruitment, performance evaluation, promotion, compensation and the estimation of personnel needs, as required under Article 74 of SAS No.46.
- B. The firm did not have policies and procedures regarding the fact that failure to comply with the firm's policies and procedures may result in disciplinary action, as required under Article 77 of SAS No.46.

(5) Engagement Performance

- A. The audit engagement did not complete the assembly of final files within 60 days after the date of the auditor's report, as required under Article 102 of SAS No.46.
- B. The firm did not establish policies and procedures requiring an engagement quality control review for all audits of financial statements of listed entities, nor did the firm require that an audit engagement partner must be eligible to be an engagement quality control reviewer for an audit of financial statements of listed entities, as required under Article 32 and 95 of SAS No.46.
- C. The firm did not have policies and procedures requiring an engagement quality control review for all engagements meeting the criteria before the date of the auditor's report, as required under Article 32 of SAS No.46.

- D. The firm did not establish policies and procedures for dealing with and resolving differences of opinion within the engagement team, with those consulted and, where applicable, between the engagement partner and the engagement quality control reviewer, as required under Article 41 of SAS No.46.
- E. The firm did not have policies and procedures to regulate the retrieval process, retrieval duration and provide a record of changes made to engagement documentation, nor related norms and control processes with respect to the changing of working papers without authorization, loss or damage, as required under Article 110 of SAS No.46.
- F. People within the firm can access the place where engagement documentation is stored without authorization. Thus, controls that the firm designs and implements cannot maintain the confidentiality, safe custody, accessibility and retrievability of engagement documentation, as required under Article 106 of SAS No.46.
- G. The report of the expert outside the firm was dated after the EQC review report and the audit report date. Thus, the firm did not achieve effective consultation nor appropriately documented and implemented, as required under Article 88 of SAS No.46.

(6) Monitoring

- A. The firm did not have policies and procedures regarding the inspection cycle policies and procedures of monitoring, as required under Article 47 and 114 of SAS No.46.
- B. The firm did not have policies and procedures regarding determining the kinds of deficiencies and further action to comply, as required under Article 46 to 51 of SAS No.46.

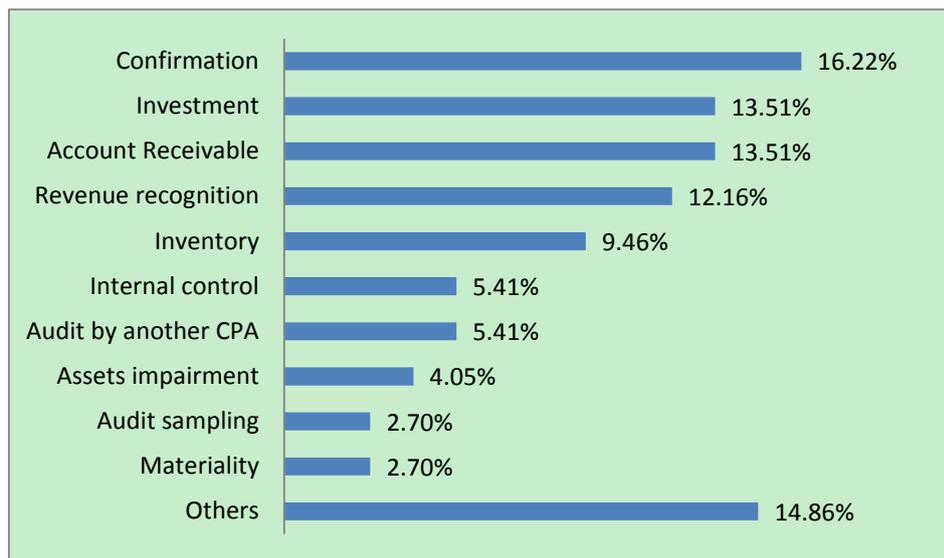
(7) Documentation of the Quality Control System: The firm did not have policies and procedures regarding the retention period for conducting internal quality control review, as required under Article 58 of SAS No.46.

(IV) Analysis of review findings 2009-2014

The FSC commenced the inspection activities starting in 2009. In 2011, the FSC entered into Cooperative Arrangement with the Public Company Accounting Oversight Board (PCAOB) of the United States. The FSC successfully did the first cycle of inspections on all big-four audit firms and ten medium/small size audit firms until 2012. Subsequently, in 2013 the FSC began the second inspection cycle, and had inspected six audit firms up to the end of 2014. To assure the audit firms' capability in auditing IFRSs financial reports, the FSC executed the IFRSs thematic inspection on 54 medium/small audit firms during 2011 and 2012. The analysis of review findings 2009-2014:

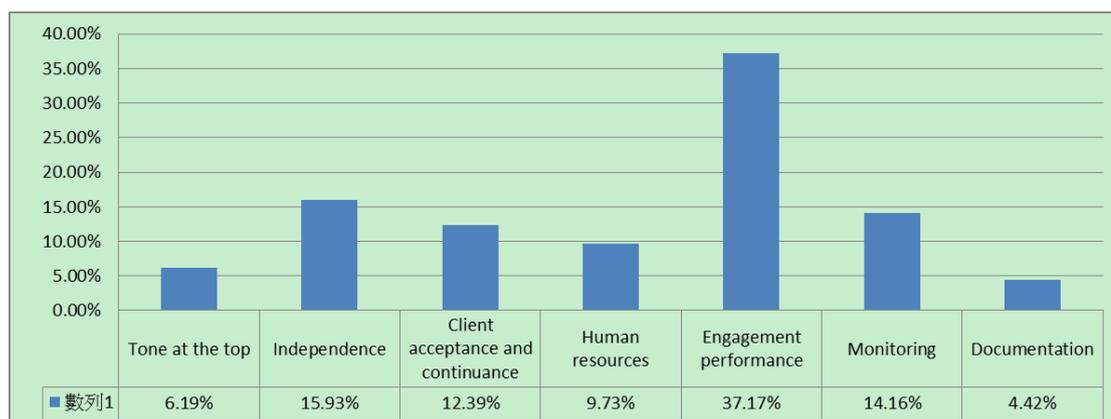
1. File review findings

Confirmation	Investment	Account Receivable	Revenue recognition	Inventory	Internal control	Audit by another CPA	Assets impairment	Audit sampling	Materiality	Others
12	10	10	9	7	4	4	3	2	2	11



2. Firm review findings

	Tone at the top	Independence	Client acceptance and continuance	Human resources	Engagement performance	Monitoring	Documentation	Total
findings	7	18	14	11	42	16	5	113
%	6%	16%	12%	10%	37%	14%	4%	



IV. Conclusion

This general inspection report is a summary of the major findings observed from FSC's inspection conducted in 2014 and the inspection findings during 2009-2014. By releasing the deficiencies, the FSC expects audit firms to undertake necessary measures to improve engagement audit quality and to comply with related regulations and the GAAS. It is also expected that audit firms will continue initiatives reviewing their audit practices to ensure high quality audits, with the aim of increasing the trust of investors in audit quality and bolster the transparency of capital markets.

The Financial Supervisory Commission 金融監督管理委員會

Add:18F., No.7, Sec. 2, Xianmin Blvd., Banqiao District, New Taipei City 22041, Taiwan

Tel:886 2 89680800

www.fsc.gov.tw

The Financial Supervisory Commission (FSC, Taiwan) was established on 1 July 2004

as the competent authority responsible for development, supervision, regulation, and examination of financial markets and financial service enterprises in Taiwan. The FSC seeks to ensure safe and sound financial institutions, maintain financial stability, and promote the development of our financial markets. Since its establishment, the main goals of the FSC have been to: create a sound, fair, efficient, and internationalized environment for the financial industry, strengthen safeguards for consumers and investors and help the financial industry achieve sustainable development.