



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

2016 CPA Firm Inspection

# **General Inspection Report**

**Financial Supervisory Commission, Taiwan**

Jan 2017

*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 was 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 aims to increase 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 Dec. 2016, the number of CPAs and the distribution of the types of CPA firms and practicing CPAs were as follows:

Status of CPAs	Num.	%
Have applied to conduct auditing and attesting business for public company financial reports	745	10.4
Have applied to the competent authority for practice registration	3,758	52.4
Hold CPA certificate but do not practice as a CPA	3,420	47.6
Hold CPA certificate	7,178	100

Single-person CPA firm		Joint CPA firm		Co-location CPA firm		Total
Num.	%	Num.	%	Num.	%	
1,560	77%	427	21%	47	2%	2,034

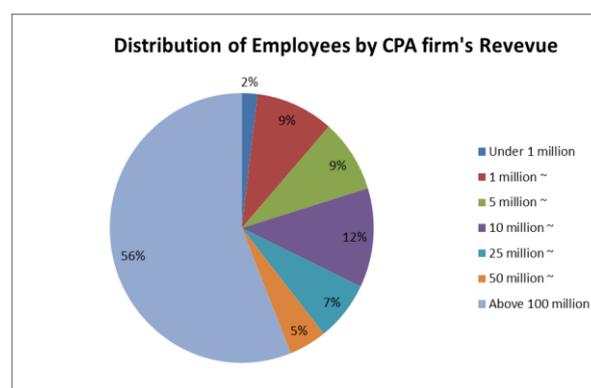
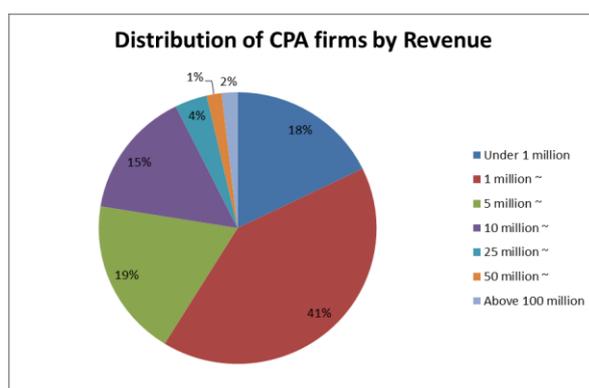
CPAs that have applied to the competent authority for practice registration	Big Four* audit firms	Mid-tier audit firms
Have applied to conduct auditing and attesting business for public company financial reports	331	414
Have not applied to conduct auditing and attesting business for public company financial reports	29	2,984

\* The Big Four audit firms in Taiwan are Deloitte, PWC, KPMG and Ernst & Young.

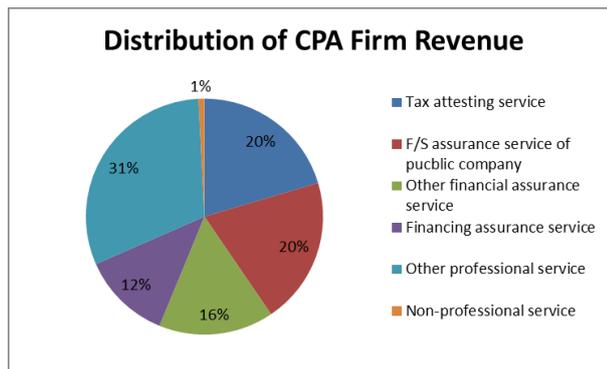
(II) According to the latest Annual Survey of the Accounting Profession of Taiwan, the figures for the revenue of the 1,034 surveyed CPA firms and number of employees at the end of 2015 were:

1. The scale of CPA firm revenue:

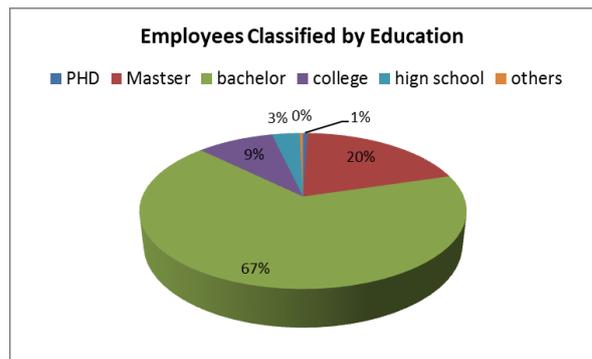
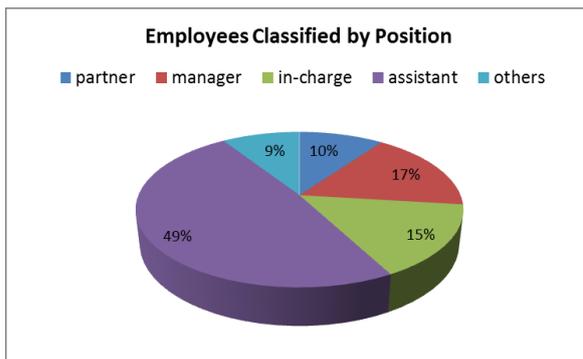
Revenue range	Num. of CPA firms		Num. of employees		2014 Revenue	
	Firm Num.	%	Employee Num.	%	Revenue (thousand)	%
Total	1,034	100.0	20,400	100.0	28,148,522	100.0
Under 1 million	184	17.8	392	1.9	77,318	0.3
1 million ~	424	41.0	1,947	9.5	1,183,164	4.2
5 million ~	194	18.8	1,791	8.8	1,383,694	4.9
10 million ~	156	15.1	2,428	11.9	2,280,988	8.1
25 million ~	39	3.8	1,466	7.2	1,358,742	4.8
50 million ~	18	1.7	941	4.6	1,141,842	4.1
Above 100 million	19	1.8	11,435	56.1	20,722,774	73.6



2. The type of CPA firm revenue: According to the Annual Survey of the Accounting Profession, the major part of firm revenue is professional service revenue in 2015(99.2%), and non-professional service is only 0.8%. Of professional service revenue, the tax attesting service, the financial report assurance service for public companies, other financial assurance service, financing assurance service and other professional service account for 20.4%, 20.1%, 15.7%, 12.2%, and 30.8%, respectively.



3. The composition of employees: There were 20,400 employees in the 1,034 CPA firms surveyed. The employees classified by position were assistant, manager, in-charge, partner, and others (49%, 17%, 15%, 10% and 9%, respectively). In addition, the employees classified by educational level were mainly bachelor, master, and college level(67%, 20%, and 9%, 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 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 2016:**

In 2016, the Financial Supervisory Commission (FSC) conducted inspections on four CPA firms. The findings were:

#### **1. Review of Individual Audit Engagements:**

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

- A. Assessment about the reasonableness of sales revenue recognition.
- B. The factors taken into account to determine materiality for the financial statements as a whole.
- C. Assessment about whether the audited entity had substantive control over invested company or related party.
- D. The materiality for auditing of group financial statements was different from that documented in the working papers.
- E. The auditor failed to file the up to date Operational Procedures for Loaning Funds to Others of the entity into the working papers, and also did not file the plan of observation of the inventory counting and leasing contract of the entity's major revenue.
- F. The analysis about the result of the inventory impairment test.
- G. The assessment about the internal control system of subsidiaries and equity investments.
- H. The assessment about the internal control system of subsidiaries and equity investments.

(2) Failed to execute the audit plan appropriately

- A. The auditor documented the overall responses to address

the assessed risks of material misstatement at the financial statement level, and the nature, timing and extent of the further audit procedures performed in the working papers, but those procedures lacked linkage with the assessed risks at the assertion, as required under Article 27 of Taiwan SAS No.49 "The Auditor's Responses to Assessed Risks" (referred to as "SAS No.49" hereinafter).

- B. It was found that the firm only made inquiries of the accounting officer and the internal auditor but did not include management and those charged with governance, as required under Article 32 of Taiwan SAS No.43 "Consideration of Fraud in a Financial Statement Audit" (referred to as "SAS No.43" hereinafter).
  - C. The auditor did not obtain an understanding of the characteristics of manual elements and automated elements of the entity's internal control that relevant to the auditor's risk assessment, as required under Article 81-87 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).
  - D. The auditor did not review the appropriateness of the materiality for the financial statements as the audit progressed, nor evaluate the necessity to revise the materiality level or levels for particular classes of transactions, account balances or disclosures, as required under Article 24 of Taiwan SAS No.51 "Materiality in Planning and Performing an Audit" (referred to as "SAS No.51" hereinafter).
- (3) The auditor failed to ascertain whether the audited entity's "loans to and endorsements/guarantees for others" had been handled in compliance with statutory provisions as well as the established operating procedures. Thus, the auditor violated Article 20, subparagraphs 4.3 and 20.1 of the Regulations.
- (4) The auditor failed to adequately document the audit trail showing that the engagement partner had taken responsibility

for the direction, supervision and performance of the audit, as required under Article 24, subparagraphs 1.4 of Taiwan SAS No.45 "Audit Documentation".

- (5) The findings regarding performing tests of internal controls:
- A. The auditor failed to properly evaluate the internal control system of the entity before performing tests of controls, as required under Article 12、17 and 93 of SAS No.48.
  - B. The auditor performed the walkthrough test of sales revenue only according to the interview with the entity's personnel, and failed to properly evaluate the internal control system of sales revenue cycle. The walkthrough test of sales revenue did not include the full process of the cycle, nor include the basis of choosing the control points in the working papers. Thus, the auditor did not comply with Article 20, subparagraphs 1.3.A. of the Regulations.
  - C. The control points when performing control test of purchasing cycle were different from those be selected in the stage of planning an audit of financial statements, as required under Article 20, subparagraphs 1.14.A. of the Regulations.
  - D. The auditor failed to include new top ten sales customers in the audit sample, as required under Article 20, subparagraphs 1.3.A. of the Regulations.
- (6) When performing accounts (notes) receivable confirmation procedures, the auditor failed to adequately document the audit trail of confirmations collected by e-mail. The working paper did not document the reasons of confirmations collected by Fax and confirmations send and collected by auditors in person. Thus, the auditor did not comply with Article 29 of Taiwan SAS No.38.
- (7) The group engagement team only obtained the notice about the receipt of audit communication and the "declaration of impartiality and independence" signed by the component auditors, but did not obtain the other matters relevant to the group engagement team's conclusion with regard to the group

audit, as required under Article 42、60 and 61 of Taiwan SAS No.54 “Special Considerations—Audits of Group Financial Statements” (referred to as “SAS No.54” hereinafter).

- (8) The auditor did not conduct an on-site inventory counting of securities on hand, nor properly evaluate financial assets for possible impairment on the balance sheet date. The auditor thus violated Article 20, subparagraph 1.2.D. and 1.2.G. of the Regulations.
- (9) The auditor did not verify whether material accounts receivable were offset against the same parties to which the sales were made, as required under Article 20, subparagraph 1.3.G. of the Regulations.
- (10) The auditor failed to observe the on-site inventory or conduct a joint on-site inventory counting of property, plant and equipment, as required under Article 20, subparagraph 1.9.A. of the Regulations.
- (11) The auditor failed to obtain the "declaration of impartiality and independence" signed by the component auditors, as required under Article 103 of Taiwan SAS No.54.

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

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

- A. The firm did not communicate the results of the firm’s quality control system, nor convey to employees the fact that its quality policies and procedures recognize and reward high-quality work, as required under Article 59 of SAS No.46.
- B. The firm failed to establish the performance evaluation criteria that give consideration to the responsibility of personnel for the firm’s quality control review result. The firm also failed to take into account quality control execution results in partner performance evaluation. These deficiencies constituted violations of Article 11 of SAS No.46.

## **(2) Ethical Requirements**

- A. The firm's policies stipulated that the partners, the audit team and their families are not allowed to hold the securities issued by the firm's clients, but the firm failed to carry out any audit procedure to ascertain the adequacy of the declaration. Hence, the firm violated Article 16 of SAS No.46.
- B. The firm did not establish policies and procedures for the rotation of the engagement partners of listed companies. The firm failed to set out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time, as required under Article 20、66 and 67 of SAS No.46.
- C. The firm failed to evaluate the independence of its personnel based on the latest "Norm of Professional Ethics for Certified Public Accountant of the Republic of China"(the Norm) and "Certified Public Accountant Act"(CPA Act), nor establish appropriate procedures when breaches of independence requirements were identified. The firm did not establish policies and procedures to provide it with reasonable assurance with respect to engagement partners handling accounting matters on behalf of clients that create threats to independence. Thus, the firm violated Article 47 of CPA Act、the Norm No.10. and Article 7 of the Norm Enforcement Rules.

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

- A. The firm did not finish the evaluating procedures before deciding whether to accept an engagement with a new client or continue an existing engagement, as required under Article 22 of SAS No.46.
- B. The firm did not establish policies and procedures governing withdrawal from an engagement due to the client taking the initiative in withdrawing the engagement, and it could easily

lead to dispute about whether a continuing relationship exists between two sides. Hence, the firm violated Article 22 of SAS No.46.

**(4) Human resources:**

- A. The firm failed to specify employee annual training hours meeting firm requirements as a performance evaluation item. It was found that some performance evaluation forms were filled in by the employees who were reviewed, not by the manager or the engagement partner. The firm did not comply with Article 76 and 77 of SAS No.46.
- B. The firm's policy stated that it shall assign appropriate personnel with the necessary competence and capabilities to perform engagements, but the firm did not document the assessment process, as required under Article 28 of SAS No.46.
- C. It was found that a new partner did not submit the relevant documentation in accordance with the firm's requirements when joining the firm.

**(5) Engagement Performance**

- A. The firm failed to conduct the engagement quality control review in a timely manner, as required under Article 93 of SAS No.46.
- B. The firm did not set out criteria regarding whether or not to perform engagement quality control (EQC) reviews for the audits of financial statements of unlisted companies. Thus, the firm violated Article 32 of SAS No. 46.
- C. The firm's quality control material (e.g. audit programs, standardized forms) was not updated or revised in line with the newly issued Taiwan Statements of Auditing Standards, or with IFRSs. The firm also failed to design an industry or subject matter-specific guidance materials. Hence, the firm did not comply with Articles 82 of SAS No. 46.

- D. The number of filed documents was different from the number of final assembly files on sampling engagement. Thus, the firm could not maintain the safe custody, accessibility and retrievability of engagement documentation, as required under Article 44 of SAS No. 46.
- E. The firm did not have policies or procedures to regulate the ownership of engagement documentation, as required under Article 16 of SAS No.45 and Article 93 of SAS No.46.
- F. 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.

**(6) Monitoring**

- A. The firm failed to perform monitoring procedures with each element of its established quality control policies, nor fill in the monitoring checklist in line with the firm's policies and procedures, as required under Article 112 and 113 of SAS No.46.
- B. It was found that those performing the engagement were involved in the engagement quality control review. Thus, the firm failed to comply with Article 46 of SAS No.46.
- C. The firm established policies and procedures to communicate the results of the monitoring of its system of quality control to engagement partners and other appropriate individuals within the firm annually, but did not set out the definition of "other appropriate individuals". The firm failed to adequately document the audit trail showing communicating the results to relevant individuals. Hence, the firm did not comply with Article 52 of SAS No.46.
- D. The firm failed to establish policies and procedures related to complaints and allegations, nor establish clearly defined channels for firm personnel to raise any concerns. Thus, the firm failed to comply with Article 54 of SAS No.46.
- E. The firm did not have the criteria for the eligibility and

responsibility of engagement quality control reviewers, as required under Article 46 of SAS No.46.

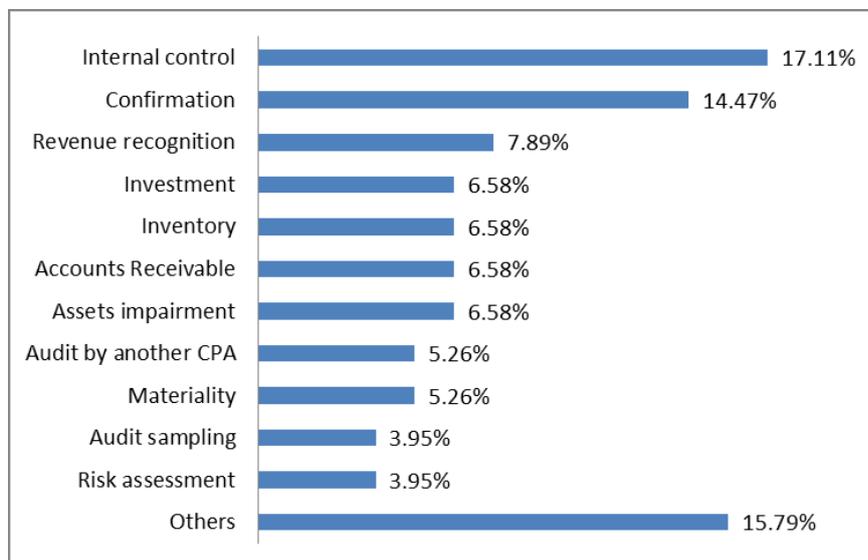
- F. The firm's monitoring checklist was not updated in line with the newly issued Taiwan Statements of Auditing Standards or the Taiwan Statement of Financial Accounting Standards, nor did the monitoring reviewer sign the date on the checklist. Thus, the firm failed to comply with Article 112 of SAS No.46.

**(IV) Analysis of review findings 2012-2016**

The FSC commenced the audit firm inspection activities starting in 2009. In 2011, the FSC entered into a Cooperative Arrangement with the Public Company Accounting Oversight Board (PCAOB) of the United States and has conducted joint inspection on local firms since then. The FSC has successfully performed the cycle of inspections on all big-four audit firms twice and eighteen medium/small size audit firms up to 2016. To assure the audit firms' capability in auditing IFRSs financial reports, the FSC undertook the IFRSs thematic inspection of 54 medium/small audit firms during 2011 and 2012. The analysis of inspection findings 2012-2016 is as below:

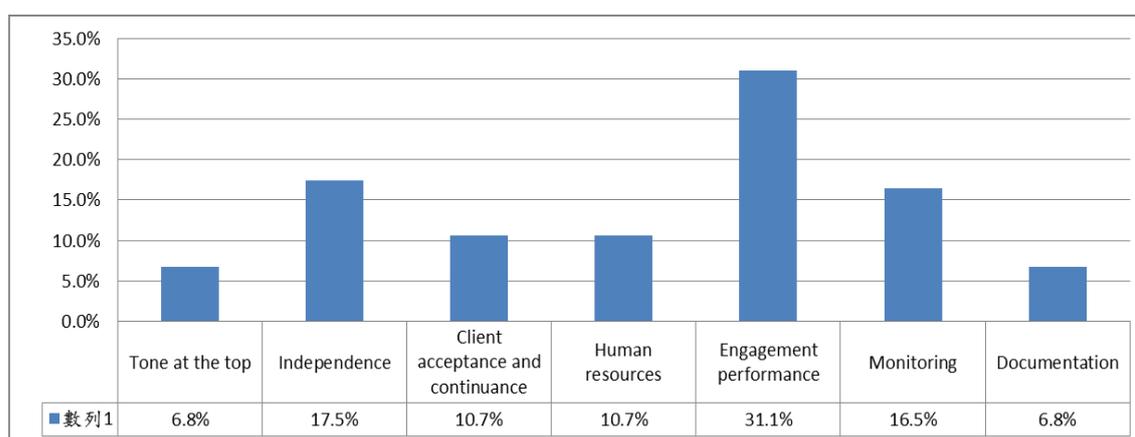
**1. File review findings**

Internal control	Confirmation	Revenue recognition	Investment	Inventory	Accounts Receivable	Assets impairment	Audit by another CPA	Materiality	Audit sampling	Risk assessment	Others
13	11	6	5	5	5	5	4	4	3	3	12



## 2. Firm review findings

	Tone at the top	Independence	Client acceptance and continuance	Human resources	Engagement performance	Monitoring	Documentation	Total
findings	7	18	11	11	32	17	7	103
%	6.8%	17.5%	10.7%	10.7%	31.1%	16.5%	6.8%	100%



## IV. Conclusion

This general inspection report is a summary of the major findings observed from the FSC's inspection conducted in 2016 and the inspection findings 2012-2016. By publication of the deficiencies, the FSC expects audit firms to undertake necessary remedial measures to improve engagement audit quality and to comply with related regulations and the GAAS. It is also expected that audit firms will continue to proactively review their audit practices to ensure high quality audits, with the aim of increasing the trust of investors in audit quality and to bolstering the transparency of capital markets.

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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.