



Financial Supervisory Commission

2019 Audit Oversight Report

June 2020



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1. Introduction

(1) The Purpose of Audit Oversight

The capital market is an important channel for issuers to raise funds. Since investors do not participate in the daily operations of companies, they are not able to know the real operating performance of companies. As such, there is “information asymmetry” between managers and investors in capital market financing. To mitigate the information asymmetry, issuers are required to regularly disclose financial and business information, i.e. financial reports, for investor reference. The verification of the accuracy of issuer's financial information relies on the audit work done by a third party, which is the purpose of audit services.

The audit services provided by auditors is an important external monitoring mechanism and also the foundation of well-functioning capital market. Since audit quality is relevant to the reliability of financial reports and possesses the characteristics of the public goods; therefore, audit regulators around the world have established appropriate mechanisms to supervise the auditors and the audit services they provide.

The Financial Supervisory Commission (FSC) is the audit regulator in Taiwan. The Securities and Futures Bureau under the FSC is responsible for the supervision, management, enactment of legislation, and policy planning and execution of the securities and futures market and industry. One of its important purviews is audit supervision, including supervising the enactment of generally accepted audit standards (SAS) in Taiwan, approval and registration of certified public accountant (CPA), inspection of AUDIT firms, and CPA discipline as well

(2) International Audit Oversight Cooperation

**2019 Important
Global Audit
Oversight Events:**

- **Elected as IFIAR board member**
- **Joined “25% reduction metric” initiative**
- **Joint inspections with the U.S. PCAOB**

As globalization flourishes, multinational corporations are expanding their business globally, so are audit services, making it necessary and urgent for audit regulators to seek global cooperation. In light of this trend, the FSC actively participates in international audit supervision affairs. In addition to joining the International Forum of Independent Audit Regulators (IFIAR), the FSC also maintain a close cooperative relationship with the audit regulators of the U.S., Japan, and Singapore, etc.

- **Elected as IFIAR Board Member**

International Forum of Independent Audit Regulators (IFIAR) is the world's largest audit supervision organization. Since joining IFIAR in 2008, the FSC has been actively participating in IFIAR activities and held the 2015 IFIAR Plenary in Taipei. Furthermore, the FSC was elected as an IFIAR board member in 2019 with a 4-year term. The FSC has been deeply engaging in discussions and the decisions making in the board meeting. The IFIAR Board is the governing body of IFIAR, and there are currently 16 members, including the U.S., Britain, Japan, Germany, France and the FSC. The FSC is also a member of the "Audit and Finance Committee (AFC)", which is under the IFIAR board. The IFIAR has six working groups, inclusive of Enforcement Working Group (EWG), Global Audit Quality Working Group (GAQWG), and Inspection Workshop Working Group (IWWG), among others. Besides, the FSC is a member of EWG and has been engaged in numerous activities organized by EWG. Every year, the FSC sends staff to attend Inspection Workshop to share and exchange inspection developments.

- **Joined the “25% Reduction Metric” Initiative**

To improve global audit quality, the FSC joined the "25% reduction metric" initiative proposed by GAQWG. The main purpose of this initiative is urging the Global Public Policy Committee (GPPC) of Big Six (Deloitte

Touche Tohmatsu, PricewaterhouseCoopers, KPMG, Ernst & Young, BDO and Grant Thornton) to improve their audit quality through the collaboration of global audit regulators.

IFIAR members participating in the initiative span 25 countries, including Britain, the U.S. and Japan. The 2019 IFIAR survey which compiled inspection reports issued by global audit regulators before June 2019 will serve as a baseline for the measurement. (i.e. the inspection results in 2018.) The GPPC networks agreed to measure results against a reduction of at least 25% over four years (until 2023) in the rate of listed public interest entities (PIEs) engagements with one or more findings. The initiative aims to urge the GPPC to improve audit quality within this time frame through setting concrete targets and timetable.

- **Joint Inspections with the U.S. PCAOB**

With the internationalization of capital markets, there is increased demand of large companies to raise funds overseas, and the main overseas fundraising market for domestic companies is the United States. In response to this trend, the FSC has worked with the U.S. Public Company Accounting Oversight Board (PCAOB) since 2011 to implement joint inspections and enhance cooperation through sharing and exchanging inspection information, inspection techniques and experiences.

2. Overview of the Audit Market

(1) The Size, Number, and Employees of Audit Firms

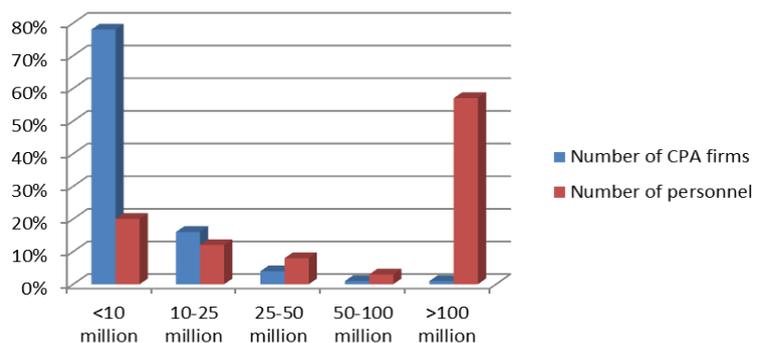
In accordance with the "2018 Audit Firms Survey Report" based on 1,291 audit firms surveyed in 2018, the scale and distribution of Audit firms' income from professional practice, and relevant information of employees are as follows:

Table below indicates there are 16 firms with income from professional practice more than NT\$100 million in Taiwan. Although the 16 firms aforementioned only account for 1% of total firm, they hire about 57% of employees for the audit firms

Table 2-1: Distribution of Audit firms by income vs. number of firms and employees

Income from professional practice	Number of audit firms	Number of employees
<10 million	884 (78%)	4,198 (20%)
10-25 million	176 (16%)	2,657 (12%)
25-50 million	45 (4%)	1,673 (8%)
50-100 million	13 (1%)	707 (3%)
>100 million	16 (1%)	12,356 (57%)
Total	1,134 (100%)	21,591 (100%)

Figure 2-1: Distribution of Audit Firms by Income Vs. Number of Audit Firms and Employees



(2) Market Share

As of the third quarter of 2019, the market share of audit firms operating in the PIEs segment are shown in the Table below. The market shares of large, medium and small audit firms are 89%, 6% and 5% respectively.

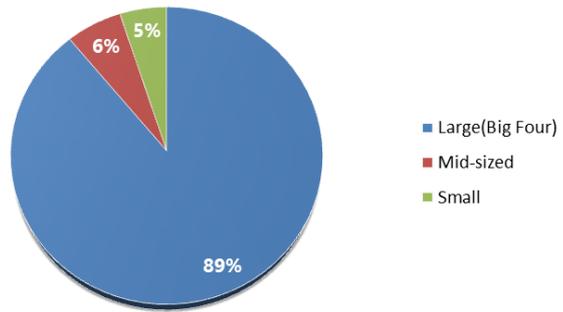
Table 2-2: The market shares of Big Four in the PIEs segment

	TWSE listed	TPEX listed	Emerging stocks trading on TPEX	Other Public companies	Total
Large (Big Four)	91%	88%	97%	83%	89%
Mid-sized	6%	6%	2%	8%	6%
Small	3%	6%	1%	9%	5%
Total	100%	100%	100%	100%	100%

Large audit firms here refer to those who audit more than 100 PIEs (including TWSE and TPEX listed, Emerging stocks trading on TPEX and public companies); medium-sized audit firms refer to those who audit 10 to 100 PIEs; and small accounting firms refer to those who audit fewer than 10 PIEs. There are four large audit firms in Taiwan and worldwide: Deloitte Touche Tohmatsu, PricewaterhouseCoopers, KPMG and Ernst & Young. In terms of the auditing of PIEs segment, the market share of Big Four in Taiwan accounts for 89% while that of Big Four in major capital markets such as the S&P 500 in the U.S. accounts for 99%, and that of the UK FTSE 350 accounts for 97%, indicating that the big four concentration is a worldwide phenomenon.

Market share of Big Four in Taiwan accounts for 89%. The concentration level here is similar to major capital markets.

Figure 2-2: The Market Shares of Big Four in Auditing and Attesting of Pies



3. Audit Quality

Audit quality is the hallmark of an auditor's profession; however, audit quality is not easily observable so there is not a universal recognized meaning or definition of audit quality yet. This characteristic make it difficult for the audit committee, investors and other stakeholders to evaluate the results of auditors' work. In light of this, there is increased interests in the measurement of audit quality: the audit quality indicators (AQIs). AQIs is a portfolio of quantitative indicators of audit quality. Countries such as the U.S. and Canada have encouraged audit firms or audit committees to adopt AQIs. Although Taiwan has not adopted AQIs yet, the FSC has been keeping an eye on the developments of AQIs worldwide.

There are a couple of factors that might affect audit quality and can be roughly divided into two major factors: "Profession" and "Independence". "Profession" means that auditors should be familiar with audit standards and laws, quality control systems and client's industry. Auditors should also possess professional judgment and knowledge. As for "Independence", it refers to auditors conduct audit work in an independent position weather in terms of form or substance, and submit unbiased opinions. To better understand the audit quality in our jurisdiction, the FSC has collected the "profession" and "independence" related information since 2019. As the Big Four accounts for 90% of the market share of PIEs, they play a decisive role for Taiwan's audit quality. Considering that, the FSC gather the information to estimate reasonable ranges of various indicators for supervision reference.

Factors affecting audit quality: Profession and independence.

"Profession": Familiar with professional standards and laws, CPA firm's quality control systems and client's industry and possessing professional judgment.

"Independence": Conducting audit work in independent stance whether in appearance or in substance and submit unbiased opinions.

- **Profession indicators:** Proportion of managers, proportion of professional consultants, proportion of partner's and manager's engaging hours to total audit hours, partner's experience, proportion of audit engagement quality control review (EQCR) hours, and training hours.
- **Independence indicators:** Length of audit engagement accepted and audit fees

Since there is no consensus on the definition of audit quality yet and there is not a single indicator which could fully capture an audit firm's audit quality, it is worth noting that the interpretation of the data should be done with particular caution and it is not appropriate to judge a firm's audit quality by a single number.

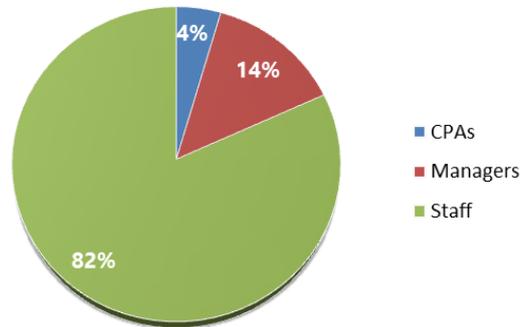
The Audit quality related information of Taiwan's Big Four is summarized as follows:

Profession

(1) Proportion of Managers

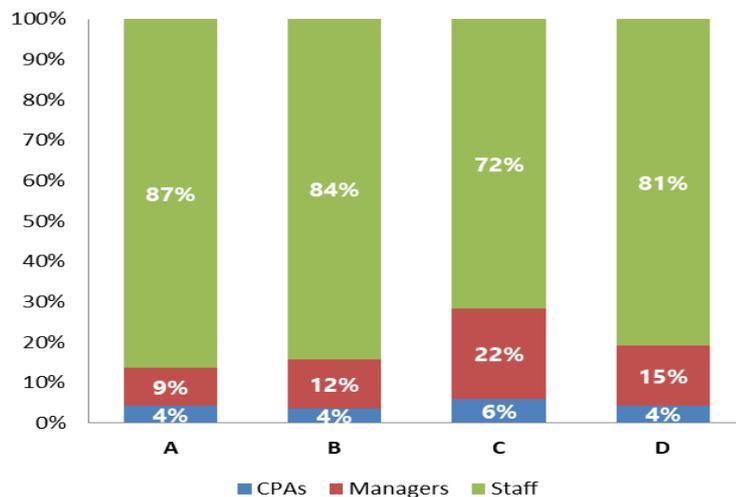
Employees in audit firms can be roughly divided into three levels: CPAs (partners), managers and staff. The proportion of CPAs, managers and staff in audit firms were 4%, 14% and 82%, respectively, taking the shape of a pyramid.

Figure 3-1: Composition of Employees in Big Four



Managers in audit firms usually have more than 5 years of audit experience. Considering that managers take on the majority of the execution and monitoring of audit work and also hold the duty to coach new recruits, the quality and number of managers have a significant impact on audit quality. Therefore, the proportion of managers to auditors reflects audit quality to some extent. As can be seen from the figures below, the proportions of partners of Big Four are quite similar and closely to 5%, whereas the proportions of managers of Big Four fall between 9% and 22%. The reasons may lie in the different seniority or qualification requirements for managers among Big Four, which make it difficult to draw meaningful inferences about audit quality simply based on this ratio.

Figure 3-2: Composition of Audit Employee in Big Four



(2) Proportion of Professional Consultants

Professional consultants are the in-house experts, who possess professional knowledge and support auditors' work. The professional consultants may include the experts in the knowledge management department or risk management department but not include those from tax affairs or any other departments not direct relevant to financial reports audit, nor the personnel from administration and general support service sections such as human resources and information technology. Auditors may request for audit support for various professional areas such as asset evaluation, computer-assisted audit techniques or legal consultations. Therefore, the proportion of professional consultants reflects an audit firm's professional backup capacity, i.e. the higher the ratio, the better the audit quality.

The following Table shows the proportions of professional consultants in Big Four. Overall speaking, each professional consultant supports about 61 auditors.

Table 3-1: Proportion of Professional Consultants

	A	B	C	D	Average
Proportion of professional consultants	1/61	1/88	1/58	1/39	1/61

(3) Proportion of CPA's and Manager's Engaging Hours to Audit Hours

Quality of human resources and audit hours of auditors are key factors affecting audit quality. However, it is hard to obtain objective metrics for the quality of human resources. As such we use proportion of senior-level auditors as an alternative measurement. There should be a positive correlation between proportion of CPA's and manager's audit hours to total

audit hours and audit quality. As seen from the Table below, CPAs and managers generally accounted for 13% of total audit hours.

Table 3-2: Proportion of CPA's and manager's engaging hours to total audit hours

	A	B	C	D	Average
Proportion of CPA's and manager's engaging hours to total audit hours	11%	13%	21%	9%	13%

(4) CPA's Professional Experience

CPA's professional experience also affects audit quality. The following Table illustrates the CPA's seniority after his appointment as a partner. On average, the CPA's seniority after his appointment as a partner is 11 years; the differences of CPA's average seniority among Big Four are not significant.

Table 3-3: CPA's Professional Experience (Years)

	A	B	C	D	Average
CPA's professional experience (years)	11	11	12	9	11

(5) Proportion of Audit Engagement Quality Control Review Hours to Audit Hours

According to Taiwan SAS No. 46, "Quality Control of Audit firms" (hereinafter referred to as "SAS No. 46"), audit engagements of TWSE and TPEX listed companies should implement quality control review before issuing audit reports. Audit engagement quality control review (EQCR) hours would have positive impact on audit quality. As a result, the proportion of EQCR hours to total audit hours reflects audit quality.

A CPA auditing and attesting financial reports of PIEs is required to take no less than 40 hours of continuing professional education courses each year.

The following Table shows the proportion of EQCR hours to total audit hours for the TWSE and TPEX listed company audit engagements audited by Big Four. The average ratio is close to 0.72%. However, there are significant differences between the results of Big Four.

Table 3-4: Proportion of EQCR Hours to Total Audit Hours

	A	B	C	D	Average
Proportion of EQCR hours to total audit hours	0.74%	0.92%	0.59%	0.39%	0.72%

In addition, although SAS No. 46 only prescribes that audit firms should carry out quality control review in audit engagements of TWSE and TPEX listed companies, three of the Big Four have implemented quality control review for all audit engagements of PIEs, demonstrating these audit firms' commitments to enhance audit quality.

(6) Professional Training Hours

Professional training is conducive to the quality of auditors. Based on Article 5 of "Regulations Governing CPA Continuing Professional Education", a CPA auditing and attesting financial reports of PIEs are required to take at least 40 hours in continuing professional education courses each year. The following table summarizes the audit employees' average professional training hours in 2018, including CPAs, managers and staff. Overall, the average is 82 hours per person, which is about twice the legal requirement for continuing professional education hours.

Table 3-5: Professional training hours

	A	B	C	D	Average
Average annual training hours of audit personnel	69	91	92	85	82

Independence

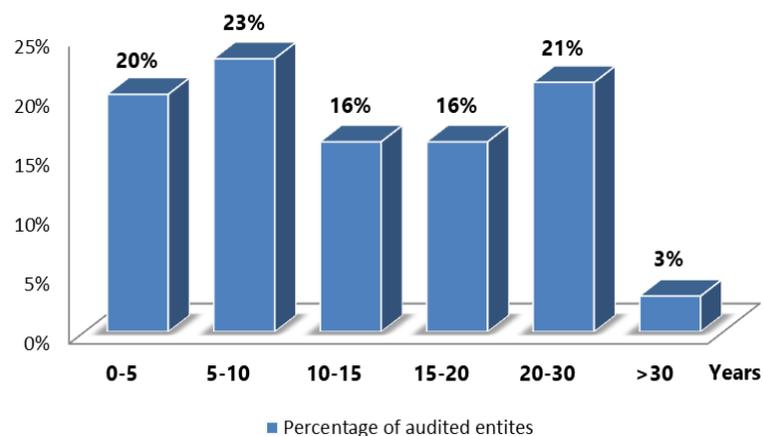
(1) Audit Firm Tenure

According to Article 68 of SAS No. 46, CPAs should be rotated after 7 years with a cooling-off period of no less than 2 years.

Familiarity with audit clients may affect auditors' independence. Familiarity can be measured by the tenure of a CPA or audit firm for an audit client; many countries have stipulated rotation provision for CPAs or audit firms. According to Article 68 of SAS No. 46, audit engagements of TWSE and TPEX listed companies, CPAs should be rotated after 7 years with a cooling-off period of no less than 2 years. However, there is no rotation provision for audit firms in Taiwan currently.

The Table below shows the tenure with Big Four as of 2018. The percentage of public companies with more than 20 years of tenure with Big Four is about 24%, indicating that more than 20% of audit engagements are audited by the same audit firm. The FSC will continue monitoring the impact of this situation on the independence of auditors.

Figure 3-3: Overall tenure with Big Four



Furthermore, as seen from the Table below, there are differences in audit firms' audit years.

Table 3-6: Big Four Tenure

Audit years	A	B	C	D
0 - 5 years	20%	24%	17%	19%
5 - 10 years	23%	25%	22%	18%
10 - 15 years	16%	19%	15%	12%
15 - 20 years	14%	13%	24%	21%
20 - 30 years	24%	16%	19%	28%
Over 30 years	3%	3%	4%	3%

(2) Audit Fees

• Audit Fee Growth Rate

In practice, auditors decide the amount of audit fees based on the nature of audit engagements, such as complexity of transactions, number of subsidiaries and audit risks of audited entities. Appropriate audit fees maintain audit quality, whereas excessive or insufficient audit fees may have a negative impact on the audit quality.

In terms of revenue composition, the growth rate of financial report audit fees of PIEs, tax compliance audit fees, other non-audit fees and total income of Big Four are 4.3%, -0.2%, 5.6% and 4.1% respectively in 2018. Among them, the growth rate of financial report audit fees of PIEs (4.3%) is slightly higher than Taiwan's 2018 nominal GDP growth rate, 2.71%, which is consistent with economic trends.

The audit fee growth rates of Big Four in 2018 range between 2% and 4.7%, whereas the growth rate of non-audit fees range from about -8.6% to 27.2%.

Table 3-7: Income growth rates from PIEs for Big Four in 2018

	A	B	C	D
Audit fee growth rate	4.70%	2.00%	4.00%	4.40%
Non-audit fee growth rate	13.50%	-8.60%	0.70%	27.20%
Total revenue growth rate	6.10%	0.10%	3.40%	7.40%

The growth rate of Big Four financial reports audit fees in 2018 was between 2% and 5%, consistent with nominal GDP growth rate in Taiwan.

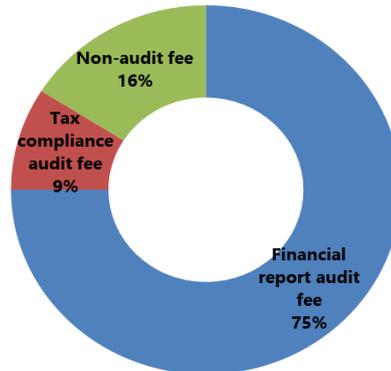
- Fee Composition-Proportions of Audit Fees and Non-Audit Fees**

Auditor's independence in auditing (or reviewing) financial reports is a key to audit quality. In addition to providing financial report audit services, CPAs also provides other non-audit services. As such, income can be divided into audit fees and non-audit fees. The amount and composition of fees may affect the independence of CPAs. If an audit firm receives too much non-audit fees from a client, it may affect CPA's independence in auditing its financial report.

The following demonstrates that, income from PIEs of Big Four amounted to NT\$ 8.2 billion, and could be divided into financial report audit fees, tax compliance audit fees and other non-audit fees, which contributed 75%, 9%, and 16% respectively. In Taiwan, non-audit fees of Big Four accounted for only 16% of overall income. Compared with a corresponding proportion of 63% worldwide, the impact of non-audit fees on

independence is less of a concern in Taiwan.

Figure 3-4: Proportions of income from PIEs of Big Four in 2018



The proportion of non-audit fees of Big Four worldwide accounted for 63%, while they contributed just 16% in Taiwan, showing that the impact of non-audit fees on independence is less serious in Taiwan.

In terms of Big Four, the proportions of non-audit fees do not differ much, which fall within the range of 15% to 18%.

Table 3-8: Proportion of Big Four non-audit fees

	A	B	C	D	Average
Proportion of non-audit fees	18%	16%	16%	15%	16%

Conclusion

- **Concerning the Profession of Audit Firms:**
 - At present, there have not been consistent criteria for reasonable quality control review hours ratio yet, making it difficult to judge an audit firm’s quality by the proportion of review hours. Whereas, given the importance of quality

control review for audit quality, the FSC will pay close attention to the implementation of quality control review in each audit firm and changing of the ratio, as well as reinforcing censoring during inspections.

- Since audit engagement quality control review is quite conducive to audit quality of audit firms, it should not be limited to audit engagements of TWSE and TPEX listed companies as mandated by GAAS No. 46 but extend the targets of quality control review to Emerging stocks trading on TPEX and public offering companies.
- Regarding the independence of audit firms: Concerning familiarity with clients, about 24% of audit engagements Big Four accepted span more than 20 years. In Taiwan, there are only mandatory rotation provisions for CPAs in this respect, whereas no mandatory requirement for audit firm rotation yet. Considering that the European Union has required the listed companies to rotate audit firms after 20 years, which demonstrates international concern toward this issue, the FSC will continue to focus on international development and make a timely evaluation whether to adjust relevant domestic regulations.

The FSC's audit oversight measures:

- **supervision of stipulation of auditing standards**
- **accountant approval, registration and practice**
- **audit firm inspection**
- **CPA discipline**

4. Overview of Audit Oversight

To ensure audit quality, the FSC takes several oversight measures such as oversight of the stipulation of auditing standards, approval and registration of CPA, audit firm inspection and CPA disciplines. Those measures are hereby enumerated as follows.

(1) Supervision of Stipulation of Auditing Standards

In response to the internationalization of capital markets and to promote the quality of audit reports, the FSC has urged the Accounting Research and Development Foundation (ARDF) to adopt "converging" approach to align with International Standards on Auditing (ISAs) since 2008. The ARDF has issued or revised 28 auditing standards since 2008. Among them, 14 standards are new, while another 14 are to replace the previous standards. Further, it plans to issue No. 73 "Using the Work of internal Auditors" in 2020 and No. 74 "The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements" to replace the current auditing standards No. 25 and No. 43.

Take the new audit report adopted internationally in recent years for example. The International Auditing and Assurance Standards Board (IAASB) released ISA 700 "The independent auditor's report on financial statement" on January 15, 2015 as well as ISA701 "Communicating Key Audit Matters in the independent auditor's report". Considering that the new audit report can effectively enhance the value and transparency of the audit report, these ISAs have been referred to formulate Taiwan's Auditing Standards No. 57 and No. 58. The FSC required CPAs to issue new audit reports for the TWSE / TPEX listed companies and financial institutions since 2016 annual financial reports. The—implementation date is earlier than that of most EU countries and the United States. This demonstrates that Taiwan actively promotes the auditing standards to be in line with international

standards.

(2) Approval, Registration and Practice of CPA

• Supervision Measures

The supervision measures for the approval, registration and practice of CPAs are explained as follows:

- Registration of CPA and audit firms: According to Article 5, Articles 8 and 12 of CPA Law, national of the Republic of China who has passed the CPA examination holds a CPA certificate, and possesses the qualifications of a CPA may practice as a CPA. A CPA certificate holder may practice nationwide as a CPA after he or she has established or joined a CPA firm, applied to the competent authority for practice registration, and joined the provincial or municipal CPA association where the head office (or branch) of his or her CPA firm is located. Provincial and municipal CPA associations shall submit the membership information of their members to the National Federation of Certified Public Accountants Associations of the R.O.C. (the "national federation") for registration and recordation.
- Audit Firms conducting business of auditing and attesting financial reports of public companies : The financial report of a public company shall be jointly audited and attested to by two or more CPAs of a joint CPA firm or incorporated CPA firm pursuant to Article 15 of the CPA Act. Before a joint or corporate accounting firm conducts financial report audits of public companies, it should obtain the approval from the FSC.

• CPA Practice Status

As of the end of December 2019, the number of CPAs, firm organization type distribution, and the distribution of CPA's practice is as follows. Among them, 45% of those with CPA certificates have been registered as a practicing CPA, and 9% were approved to audit financial reports of public companies, respectively.

Table 4-1: CPA Practice Status

CPA Practice Status	Number	%
Approved to audit public companies	703	9%
Registered as practicing CPA	3,548	45%
Certificate holders without practice	4,315	55%
Certificate holders	7,863	100%

From the Table below, the proportion of CPA approved to audit public companies in large audit firms is about 88%, whereas the proportion in small and medium-sized audit firms is about 11%. This shows that the audits of public companies are dominated by public large audit firms. The small and medium-sized audit firms focus their business on the audit of non-public companies.

Table 4-2: Entity Type Attested by CPA

Registered as practicing CPA	Large*	Small and mid-sized
PIEs	341 (88%)	362 (11%)
Non-PIEs	45 (12%)	2,800 (89%)

*: Large firms refer to Big Four: Deloitte, PwC, KPMG, and Ernst & Young.

According to article 15 of the CPA Act, audit firms are classified into 4 types: single-person, co-location, joint, and incorporate audit firms. At present, there are no incorporate audit firms. From the Table below,

single-person and joint CPA firms still dominate the market with 77% and 21% respectively.

Table 4-3: Types of CPA firms

single-person	Joint	co-location	Total
1,578	437	33	2,048
(77%)	(21%)	(2%)	(100%)

(3) Audit Firm Inspection

- **The Purpose of Audit Firm Inspection**

The Article 19 of the CPA Act stipulates that to safeguard the interests of the general public and promote the public interests, the competent authority may dispatch personnel to inspect the operations and financial status of an audit firm that has been approved to provide attestation services to public companies. An audit firm shall not avoid, impede, or refuse to cooperate with such an inspection." The purpose of the inspection is to ensure high audit quality, enhance the internal quality control of audit firms, and reduce the potential risks of audit failure. Through the inspection and promotion of high-quality auditing, the FSC aims to bolster public confidence in the audit opinions of accountants on financial reporting rather than to punish the inspected firms. If an auditor is found to have made material deficiencies or committed negligence in attestation on financial reports, or seriously violated Article 61 of the CPA Act to the extent of damaging the accountant's reputation, the FSC will refer the case to the CPA Discipline Committee for disciplinary actions.

- **Inspection Principle**

The FSC conducts the audit firm inspection with a risk-based approach. With regard to the deficiencies found in the review of quality control system or audit engagement, the FSC requires the inspected firm to take necessary remediation actions to improve their quality.

- **Focal Points of Inspections**

- **Quality control systems:** Inspectors review

audit firm's policies, procedures, and audit engagements to assess whether the CPA firm's quality control system is conducted in accordance with the requirements of the Taiwan Statement of Auditing Standards No. 46 Quality Control for Firms ("SAS No. 46" hereafter). The key inspection focus of the quality control system covers: "Leadership's responsibility for quality control in the firm (Tone at the top)", "Independence", "Client acceptance and continuance", "Human Resources", "Engagement performance" and "Monitoring".

- **Reviews of Audit Engagement:** With reference to the inspection methods of foreign auditing and supervision authorities, the FSC has shifted from a comprehensive audit method to a "Key Audit Area" method since 2019. Based on audit risk level, common deficiencies at home and abroad or supervision needs, the FSC selects a couple of accounting items or audit procedures for in-depth inspection and expands the number of reviews of audit engagements. In 2019, eight Audit engagements were selected for in-depth review for each CPA firm.

- **Inspection Methodology**

- **Quality Control Systems**

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

- **Reviews of Audit Engagement**

- ◎ Interview the audit engagement partners and

managers to understand risk assessment, audit focus, and audit method.

- ◎ Review the working papers to examine whether the audit conforms to the Regulations Governing Auditing and Attestation of Financial Statements by CPAs and the Taiwan SAS.

Key Findings for 2019 Inspection

The FSC's inspectors conducted on-site inspections of three large CPA firms in 2019. The inspection covers review of a firm's quality control system and audit engagements. The deficiencies are as follows:

- **Quality Control System**
 - The inspectors identified three quality control system deficiencies in 2019, which significantly decreased compared to 43 deficiencies last year (2018). The reason for the significant decrease is attributed to the firm scale difference. Most inspected firms in 2018 were middle-sized while all the inspected firms are large-sized in 2019. The resources and employees of middle-sized firms are much less than the large ones; hence there were less deficiencies in 2019. Particularly, one middle-sized firm inspected for the first time in 2018 was found to have more deficiencies than its peers.

Table 4-5: Deficiency of Quality Control System

	2019	2018
Number of inspected firms	3	4
Number of inspection deficiencies	3 items	43 items
Average deficiencies per firm	1	11

- In 2019, after evaluating the design and implementation of the firm's quality control system, all inspected firms were identified the failures to complete documentation of audit working paper within the deadline set by the firms.

- **Reviews of Audit Engagements**

- The inspectors reviewed 24 audit engagements and identified five deficiencies. The total number of deficiencies decreased 46% from that of the previous year. The reason for the difference is the same as described above.

Table 4-6: Deficiencies of Audit Engagement

	2019	2018
Number of Inspection Deficiencies	5 items	22 items
Number of Review of Audit Engagements	24	7
Average Number per Audit Engagement	0.2 items	3.1 items

- The inspectors reviewed the audit engagements conducted by the inspected firms and found the following deficiencies:

- **Key Audit Matters (KAM)**

- The auditors had identified major accounting or audit issues at related meetings and determined KAMs, but the reasons for not selecting some major accounting or audit issues as KAMs were not properly documented in the working paper, which violates the Articles 17 and 78 of SAS No. 58.
- The communication between the auditors and management about KAMs was recorded in the Independent Auditors' Report but how the auditor decided the matters of significant attention from communication with management and the reasons for selecting KAMs from the matters of significant attention were not properly documented in the working paper, which violates Articles 17 and 78 of the SAS No. 58.

- **Revenue recognition:** The auditor failed to check with voucher in a selected period

covering balance sheet date to ensure that sales were properly registered, which violates the Article 20, Paragraph 1, subparagraph 3, Item 14 of Regulations Governing Auditing and Attestation of Financial Statements by Certified Public Accountants.

© **Accounts Receivable:** The auditor had been aware that the identities of the seller and the payee were not the same, the auditor failed to evaluate the reasonableness of it and documented it in the working paper, which violates the Article 20, Paragraph 1, subparagraph 3, Item 7 of Regulations Governing Auditing and Attestation of Financial Statements by Certified Public Accountants.

- **The Follow-Up Procedures after Inspection**

The FSC will propose a draft of General Inspection Report within 1-2 months after on-site inspection. The inspected firms are required to provide written opinions on inspection deficiencies within 30 days, to submit a remediation plan to the FSC within 2 months and then to track the remediation progress. If the firms did not implement the remediation plan appropriately, or address deficiencies within the prescribed period by the FSC, the FSC may rescind or repeal approval of the inspected firms to conduct auditing and attesting businesses for public company financial reports under Article 10.1. (6) of the Regulations Governing Approval of Certified Public Accountants to Audit and Attest to the Financial Reports of Public Companies.

- **Communication between Management and Audit Committee and Auditors**

Management and audit committee of public companies are responsible for preparation and fair presentation of financial statements. To ensure the high

Common deficiencies of quality control system: engagement performance, human resources, monitoring and independence.

quality of financial statements, they should enhance communication with auditors by incorporating the common deficiencies listed in the Inspection Deficiencies Survey Report issued by International Forum of Independent Audit Regulators (IFIAR) into their communication.

- **Summary of Deficiencies in Recent Years**

As of 2019, the FSC has completed three inspection cycles of the Big Four for a total of 40 on-site inspections. The overview of the deficiencies over the past 5 years (2015 to 2019) is summarized as follows:

- **Quality control System:** Major deficiencies from inspection of quality control systems over the five years 2014-2018 were related to Engagement performance, Human Resources, Monitoring, and Independence. Please refer to previous inspection reports for details.

Figure 4-1: Deficiencies of Quality Control System over past Five Years

	2015	2016	2017	2018	2019	Total
Leadership responsibility for quality control	0	1	0	1	0	2
Independence	5	2	1	5	0	13
Acceptance and renewal	3	1	1	4	0	9
Human resources	3	5	0	11	0	19
Engagement Performance	11	9	5	17	3	42
Monitoring	6	6	0	5	0	17
Total	28	24	7	43	3	102

Note: From this year the FSC reclassified the categories of inspection deficiencies according to IFIAR's classification to so the number might be different from that shown in the past inspection reports.

- **Review of Audit Engagement:** Major deficiencies from audit engagement reviews were Revenue Recognition, Materiality, Internal

Common deficiencies of Review of Audit Engagement: Revenue Recognition, Materiality, Internal Control, Documentation and Confirmations.

Control, Documentation and Confirmations over the 5 years 2015-2019. Please refer to previous inspection reports for details.

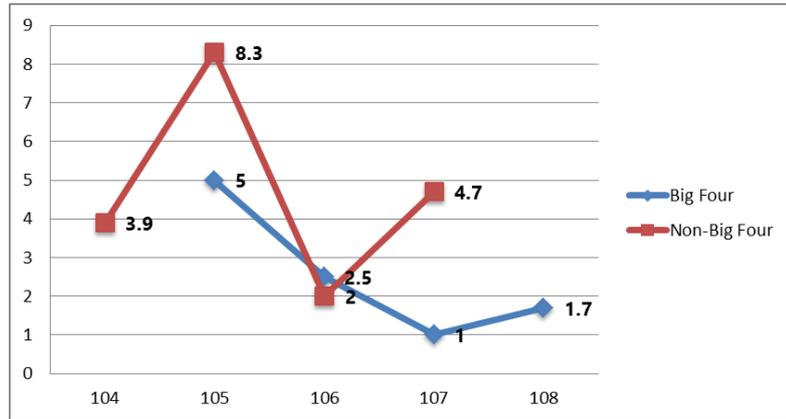
Figure 4-2: Deficiencies of Audit Engagements over the Past Five Years

	2015	2016	2017	2018	2019	Total
Group Audits	1	4	0	0	0	5
Internal Control Testing	3	7	0	0	0	10
Substantive Analytical Procedures	1	0	1	0	0	2
Fraud Procedures	3	2	0	1	0	6
Risk Assessment	5	4	0	0	0	9
Accounting estimates / fair value measurement	0	2	2	0	0	4
Revenue recognition	9	5	3	6	3	23
Inventory procedures	2	3	1	0	0	6
Related party transactions	0	2	0	1	0	3
Engagement review and management	1	1	0	3	0	5
Audit sampling	0	0	1	0	0	1
Key audit matters	0	0	0	3	2	3
Documentation	5	1	4	2	0	12
Materiality	6	8	2	4	0	20
Loaning of Fund and Making Endorsements	1	2	0	1	0	4
Others	0	2	1	1	0	4
Total	37	43	15	22	5	117

• Comparison of Big Four and Non-Big Four Deficiencies

The following figure shows the deficiencies of Big Four and non-Big Four audit firms over the past 5 years. Except for 2017, Big Four accounting firms' average audit engagement deficiencies (total audit case deficiencies / number of audit cases with deficiencies) is lower due to the possession of greater resources.

Figure 4-3: Average audit engagement deficiencies of Big Four and Non-Big Four over the past five years



Auditing Reminder: Expected Credit Losses

Findings

- In the 2019 inspection cycle, the inspectors found that some auditors failed to incorporate and document the forward-looking information used while auditing the expected credit loss of accounts receivable.

Reminders and suggestions

- The 2008 financial crisis highlighted the defect of the "incurred loss model" used by IAS 39. The model delays recognition impairment losses. Thus, the International Accounting Standards Board (IASB) proposed IFRS 9 to replaced IAS 39. The IFRS 9 substitutes an "expected credit loss (ECL) model" for the "incurred loss model". The ECL model incorporates expected information about future industries or overall economic situation and recognizes impairment losses in a timely manner. IFRS 9 requires issuer to incorporate all reasonable and corroborative information, which includes forward-looking macroeconomic information when gauging expected credit losses.
- When auditors assess the expected credit loss, the forward-looking information should be incorporated. It is recommended that the auditors follow the provisions of IFRS 9 and consider common practices. For example, take forward-looking information such as economic or business indicators issued by domestic and foreign organizations into account, and then adjust expected credit loss rate accordingly.

(4) CPA Discipline

In addition to auditor's self-discipline, audit oversight is also indispensable for the enhancement of audit quality. To impose discipline actions against the auditors who have committed serious violations of audit regulation or standards would not only bring vigilance against those got disciplined but also reminds other auditors to perform their audit work with due professional care and to reduce the risk of audit failure.

- **Disciplinary Procedures**

The CPA disciplinary in Taiwan is conducted by the CPA Discipline Committee pursuant to the Accounting Act. The CPA Discipline committee comprises members from industry, government, and academia. If an auditor is involved with activities specified in Article 61 of the Accounting Act, the FSC or National Federation of Certified Public Accountants Associations of the R.O.C. may file with the CPA Discipline Committee a petition for disciplinary action. According to Article 62 of the Accounting Act, auditor disciplinary actions include fines (NT\$ 120,000 - NT\$ 1.2 million), warnings, admonishment, a stop in business (2 months - 2 years), or delisting.

If an auditor subject to disciplinary proceedings does not accept the resolution of the CPA Discipline Committee, he or she may file with the CPA Discipline Rehearing Committee for a hearing. If the hearing applicant disagrees with the resolution, administrative litigation could be filed with the Taipei High Administrative Court. If the auditor who has been disciplined fails to apply for a review or file an administrative lawsuit within the deadline, the resolution confirmed. Once the resolution of the CPA Disciplinary Committee is confirmed, it will be published in the government bulletin and posted on the website.

- **Overview of CPA Disciplinary Actions**

The CPA disciplinary actions made by CPA Disciplinary Committee over past three years are 8, 6, and 7 respectively, and the number of auditors subject to disciplinary actions is 17, 9, and 15. The information on CPA Disciplinary Committee's resolution against auditors over past five years of, including the name of CPA, reasons, and disciplinary actions, is published on the FSC's website.

<https://www.sfb.gov.tw/ch/home.jsp?id=940&parentpath=0%2C8%2C935>

Table 4-2 Recent CPA Disciplinary Actions

	2017	2018	2019
The number of resolutions made	8	6	7
The number of accountants subject to disciplinary actions	17	9	15

5. Conclusion

In 2019, the FSC's inspection started to focus on key audit area, and increased the number of review of audit engagements, which enhances the depth and breadth of inspection. In response to the announcement of five domestic systemically important banks (D-SIBs) in June 2019 by the FSC, the FSC plans to include D-SIBs in the sample of review of audit engagements from 2020 so as to expand inspection scope and to gain a better understanding of the audit quality of banking industry. Moving forward, the FSC will assess whether to include all financial institutions in review sample. On top of that, the FSC has started collecting information on audit quality of Big Four since 2019 and will keep monitoring the changes of driving factors of audit quality, such as audit hours, EQCR hours, professional training hours, the proportion of non-audit fees and audit fees for supervision purposes.

Considering the importance of audit quality to capital market, the FSC continues fulfilling its mandate to supervise the firms to enhance their audit quality. The FSC believes that auditors do not hold the sole responsibility to enhance the audit quality; the management and audit committees should also work together to fulfill their duty to enhance the audit quality and should further strengthen their communication with auditors. The FSC expects audit committee to incorporate this audit oversight report into their communication with auditors to ensure that auditors have properly perform relevant audit procedures so as to safeguard the rights of investors.



Financial Supervisory Commission