金融監督管理委員會
Financial Supervisory Commission

2009 CPA Firms Inspection

General Inspection Report

Financial Supervisory Commission, Taiwan

April 2010

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." Inspectors from the Financial Supervisory Commission (FSC) conducted the first inspection on three joint CPA firms[1] during the second half of 2009. The purpose of an inspection is to improve audit quality, to ensure a CPA firm's quality control system is working properly, and to prevent the potential risk of audit failure. Additionally, the goal is to promote high-quality audits by exercising public supervision. Ultimately, what we want to do is not so much to impose punishments on auditors, as to enhance public confidence in financial statements and CPA audit opinions.

II. Domestic CPAs and CPA Firms:

(I) At the end of January 2010, there were 1,396 CPA firms, including 1,055 sole practitioner CPA firms (approximately 76% of all firms) and 341 joint CPA firms (approximately 24% of all firms). Among these firms, 83 were authorized to provide attestation services to public companies.

(II) At the end of January 2010, there were 5,505 licensed CPAs, of whom 2,558 were registered with the National Federation of CPAs Associations in Taiwan. Among registered CPAs, there were 687 (284 at the "big four" firms and 403 at other firms) who were authorized to audit public companies' financial statements, and 1,871 CPAs who were not.

III. Inspection Principles, Focal Points, and Methods

(I) **Inspection Principles:** The FSC has adopted the supervisory model and uses a risk-based approach to inspect CPA firms. To the extent possible, the FSC provides guidance to help CPA firms establish and implement an internal quality control system that conforms with regulations and the generally accepted auditing standards (GAAS).

[1] A "joint CPA firm" is a firm established by 2 or more CPAs acting together as partners in organizing a joint CPA firm to engage in CPA practice under Article 20 of the CPA Act.

When an FSC inspection reveals quality control deficiencies, the FSC requires the CPA firm to take necessary corrective remedies to improve audit quality.

(II) **Focal Points of Inspections:**

1. **Review of Quality Control System:** An inspection of a firm's quality control system is carried out in accordance with the requirements of Taiwan Statement of Auditing Standards No. 46 "Quality Control for Firms" ("SAS No. 46").The purpose of an inspection is to understand and assess the effectiveness of the firm's quality control system. The inspection focuses on:

   (1) Leadership responsibility for quality control within the firm (tone at the top)

   (2) Independence

   (3) Acceptance and continuance of client relationships and specific engagements (risk management mechanisms)

   (4) Human resources (partner evaluations, compensation and promotion actions, appointment of the engagement team, and continuing professional development)

   (5) Engagement performance (engagement quality control review, consultation, and differences of opinion)

   (6) Monitoring (to check the CPA firm's internal inspection program and see how well it communicates on deficiencies, addresses them, and carries out ongoing monitoring)

2. **Review of Audit Engagements:** Inspection procedures for each engagement are determined on a case-by-case basis. The FSC annually sets the focal points of inspections and uses a risk-based approach to select which audit engagements are to be reviewed.

(III) **Inspection Methods:**

1. **Review of Quality Control System**

   (1) Understand a CPA firm's quality control policies and procedures through interviews and related documents.

(2) Evaluate the design of the inspected CPA firm's internal quality control system.

(3) Conduct appropriate compliance tests to assess the effectiveness of the quality control system.

2. **Review of Audit Engagements**

(1) Interview the engagement partner and the engagement team manager to understand the risk assessment, audit focus, and audit method.

(2) 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.

(3) Use each review to examine the implementation of the CPA firm's quality control system.

IV. **Inspection Findings:**

(I) Due to various factors (e.g. the joint CPA firm's size and characteristics, the nature of its clientele, and its risk management strategies), different firms used different approaches to achieve compliance with laws and regulations and fulfill their professional responsibilities. The FSC's inspection procedures mainly included: (1) a review of selected audit engagements to evaluate how the firm conducts audits; and (2) a review of the operation of the firm's quality control system.

(II) **Review of the Audit Engagements**:

1. Audit engagements were selected for review using methods defined by the FSC. The CPA firms could not affect or limit which audit engagements were selected by the FSC for review..

2. This general inspection report published by the FSC 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 not any deficiency noted in the inspection report.

3. The FSC inspection team identified the following major audit deficiencies:

(1) In one case, the auditor failed to document the review process, or confirmations collected by fax from export customers were not recorded in the working papers. The auditor also sometimes failed to provide any evidence to show how he or she verified the reliability of the confirmations, as required by the Taiwan SAS No. 38 "External Confirmations."

(2) Article 7, paragraph 3.2.3 of the "Regulations Governing the Preparation of Financial Reports by Securities Issuers" provides that when investment gain or loss is recognized, if the financial reports of an invested company have not been prepared in accordance with Taiwan GAAP, those financial reports shall first be adjusted to achieve conformance before they may be used to recognize investment gain/loss. In one audit engagement, the Long-Term Equity Investments under Equity Method was used to recognize the investment gain/loss from the invested company's financial statements audited by the other CPA, but the FSC staff found that the engagement team failed to comply with the above Regulations. In one case, the auditor's working papers did not document the performance of the evaluation on: [a] whether the invested company's financial reports were prepared under Taiwan GAAP; [b] its differences; and [c] whether it would affect the audited company's financial report.

(III) **Review of the Quality Control Systems:** In the course of evaluating the overall audit quality of the inspected CPA firms, the FSC inspection team found the following types of defects in quality control systems:

1. **Ethical Requirements**

(1) Threats to auditor independence (e.g. self-interest, self-review, advocacy, familiarity, and intimidation) were not comprehensively addressed in the CPA firm's independence policies.

(2) The principle of engagement partner rotation as set out in Article 68 of Taiwan's SAS No. 46 was not implemented effectively.

(3) The CPA firm failed to fully evaluate all of the criteria set forth in the auditor's declaration of independence, and failed to establish or implement the related comprehensive control mechanism.

2. **Human Resources**

(1) The CPA firm required all CPAs and professionals to take a certain minimum number of annual hours of professional training, but failed to enforce the system.

(2) The CPA firm's performance evaluation system didn't provide for punishment of personnel who violated quality control policies.

3. **Engagement Performance**

(1) The CPA firm, when deciding whether to review audits and audit-related services provided to unlisted clients, considered neither the degree of public interest involved nor the irregularities and risks identified in the original audits. This deficiency increased the likelihood that high-risk engagements might go unreviewed.

(2) The firm failed to establish a specific policy to address the qualification requirements for engagement quality control (EQC) reviewers and how to maintain their objectivity. The firm also did not adopt policies and control procedures for the replacement of an EQC reviewer whose ability to perform a review is impaired.

(3) The EQC reviewer did not inspect all the items required in Article 36 and Article 92 of SAS No. 46.

(4) The CPA firm had not adopted policies and procedures governing the nature, timing, and scope of an EQC review. This constituted a failure to comply with SAS No. 46, which provides that "a review should be performed in a timely manner and at the proper stage to allow significant matters to be promptly resolved before the report date" and that "the extent of the review should depend on the complexity and risk of the engagement."

(5) Although the CPA firm did require the engagement team

to complete the assembly of final engagement files within 60 days after the audit report date, nevertheless, it failed to adopt prior control policies and procedures to ensure timely completion and filing.

(6) The CPA firm had failed to adequately design and implement policies and procedures to avoid unauthorized alteration or loss of the hardcopy working papers. This failure made it hard for the firm to maintain the confidentiality, custody, integrity, accessibility, and retrievability of working papers .

4. **Monitoring**

(1) The firm failed to adopt a rule that those performing the engagement or the EQC review are not allowed to take part in inspecting the engagement. Moreover, the firm failed in actual practice to observe any such prohibition.

(2) The firm failed to adopt a rule requiring the selection of at least one engagement for each engagement partner over an inspection cycle of a specified number of years. Moreover, the firm failed in actual practice to do so.

(3) The firm did not adopt policies and procedures for dealing with complaints and allegations.

(4) The items on the CPA firm's monitoring checklist were not entirely consistent with each element of its established quality control policies.

V. This general inspection report is a summary of the major deficiencies observed during the FSC's inspections conducted in 2009. The purpose of this report is to alert CPA firms to these deficiencies, and to spur the firms to effectively establish internal quality control systems that are in conformity with regulations and the GAAS. The FSC expects that its annual inspections will prompt each CPA firm to inspect its own internal audit quality control system and take it upon itself to improve its internal quality control system. We expect that this would enhance the quality of CPA audits and bolster public confidence in audit quality and capital market transparency.

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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 financial industry, strengthen safeguards for consumers and investors and help financial industry achieve sustainable development.