



金融監督管理委員會
Financial Supervisory Commission

2011 CPA Firms Inspection

General Inspection Report

Financial Supervisory Commission, Taiwan

March 2012

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 inspections on two joint CPA firms¹ during 2011. 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 March 2012, there were 1,702 CPA firms, including 1,318 sole practitioner CPA firms (approximately 77% of all firms), and 384 joint CPA firms (approximately 23% of all firms). Among these firms, 83 were authorized to provide attestation services to public companies.
- (II) At the end of March 2012, there were 5,975 licensed CPAs, of whom 2,905 were registered with the National Federation of CPAs Associations in Taiwan. Among registered CPAs, there were 734 who were authorized to audit public companies' financial statements, and 2,171 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 conform with regulations and generally accepted auditing standards (GAAS). When an FSC inspection reveals quality control deficiencies, the FSC

¹A "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.

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 procedure is to understand and to 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 mechanism)
 - (4) Human resources (partner evaluations, compensation and promotion actions, the 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 method. 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 the 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:

Failed to Properly Audit the Factoring and Write-off of Accounts Receivable

- (1) In one case, the audited entity had large accounts receivable and issued a promissory note in the same amount, payable to a bank. However, the auditor did not notice the promissory note during a review of the audit working papers. Additionally, the auditor did not

document the assessment on whether the promissory note amount and offset terms would influence the determination on the transfer of the risk and reward through the "sale of accounts receivable". The auditor also did not notice that the bank confirmation letter mentioned the existence of the promissory notes, and failed to verify the accuracy of the bank accounts. Thus, the auditor failed to comply with Article 20, subparagraph 3.22 of the "Regulations Governing Auditing and Attestation of Financial Statements by Certified Public Accountants" (referred to as "*the Regulations*" hereinafter) and Article 36 of Taiwan SAS No. 38 "External Confirmations.

- (2) When performing confirmation procedures, the auditor is required to verify whether material accounts receivable were offset against the same parties to which the sales were made. However, the FSC inspection team discovered that the auditor documented in the audit working paper its procedure for selecting some bank deposit books or bank statements from all banks where the client had dealings and those amounts were all ending balances without detailed entries. For that reason, the auditor could not determine whether the cash-in party of the bank amount matched with its accounts receivable. Thus, the auditor violated Article 20, subparagraph 3.7 of *the Regulations*.

Failed to Properly Perform Confirmation Procedures

- (3) In one case, when performing confirmation of related party transactions, the auditor did not prepare the confirmation control sheet and the summary of confirmation responses. The firm also failed to ascertain that the confirmation letters were sent by the auditors, and did not check the accuracy of the confirmation addresses and responses sent directly to the firm. These deficiencies constituted violations of Article 29 of Taiwan SAS No. 38 "External Confirmations."

Failed to Properly Assess Impairment of Long-Term Equity Investments

(4) In one case, a wholly owned subsidiary of the audited entity accounted for long-term equity investments at cost, but their carrying amounts were far higher than the investments' net worth. In the audit working papers, the auditor documented that the decision to conclude the temporary impairment of the long-term equity investments was based on the good prospects in the Industry Research Report without mentioning the invested company. The auditor did not sufficiently consider the invested companies' status in the industry and the assessment process of the specified association between their business operations and their respective industry prospects. Accordingly, the auditor failed to ascertain whether the audited entity had evaluated financial assets for possible impairment on the balance sheet date, and to evaluate the appropriateness of the estimation of the recoverable amount of such an asset, and of the corresponding accounting treatment by the engagement. This audit violated Article 20, subparagraph 2.7 of *the Regulations*.

Failed to Properly Audit Transactions with Invested Companies or Related Parties

(5) In such cases, the auditor is required to ascertain whether the audited entity had substantive control over invested company or related party, and if so, whether it prepared the consolidated financial statements in accordance with applicable requirements. However, the FSC inspection team found that for some companies in which the audited entity had invested, the auditor failed to fully document the audit process on the invested companies such as the audit through group components and obtaining the related material, and failed to understand the group's stock-share composition, or determine substantive control. The auditor also failed to compile the record of above process together with relevant audit evidence obtained, into working papers, thereby violating Articles 22 and 23 of *the Regulations*.

Failed to Properly Evaluate the Work of Another Auditor

(6) In one case, when planning to use the work of another auditor, the principal auditor did not conduct the following audit procedures: (i) consider the professional competence of the other auditor in the context of the specific assignment; (ii) advise the other auditor of the use of the other auditor's work or report; (iii) make sufficient arrangements for the coordination of their efforts at the initial planning stage of the audit; (iv) advise the other auditor of the accounting, auditing, and reporting requirements and obtain written representation as to compliance with them; or (v) consider the significant findings of the other auditor. These deficiencies constituted violations of Article 5 of Taiwan SAS No. 15 "Using the Work of Another Auditor." Additionally, the auditor did not document the process by which it reached the conclusion that Taiwan SAS No.15 did not apply to those subsidiaries using the work of other auditors due to their immateriality for the financial statements as a whole. Accordingly, the auditor violated Article 22 of *the Regulations*.

Others

(7) In one case, the FSC inspection team found that, in the audited entity's Statement of Cash Flow and Notes, there were errors and omissions in the disclosed information on "pledge assets," "deferred expenses as collateral "and" material commitments." However, the auditor did not detect those mistakes, which revealed a failure to exercise due professional care in the performance of the audit. This was a clear audit deficiency.

(III) **Review of the Quality Control System:** After evaluating the overall audit quality of the inspected CPA firms, the FSC inspection team found the following defects in the "Engagement Performance" aspect of the firms' quality control systems:

(1) In most cases, the firm's engagement quality control review was conducted by one of the engagement partners. (In Taiwan, a public company's financial statements must be audited by two CPAs.) This was a violation of Article 97 of SAS No. 46, which prohibits the engagement quality

control reviewer from participating in the engagement during the period of review.

(2) The engagement partners and engagement quality control reviewers signed the audit working papers without dating them. The firm's engagement quality control reviewer signed the same date in the stage of planning and performing. Thus, the firm did not effectively implement the requirement of Article 93 of SAS No. 46, which requires that "the EQC review shall be conducted in a timely manner at appropriate stages during the engagement..."

V. This general inspection report is a summary of the major deficiencies observed during the FSC's inspection conducted in 2011. This 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.

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