

ANNUAL REPORT OF THE COMMISSION FOR PUBLIC OVERSIGHT OF STATUTORY AUDITORS' ACTIVITIES FOR 2015/2016¹ – SUMMARY

The Commission for Public Oversight of Statutory Auditors (CPOSA) is an independent authority, a legal entity on budgetary funding, established in 2008 by the Independent Financial Audit Act (IFAA) in line with the requirements of Directive 2006/43/EC of the European Parliament and of the Council on statutory audits of annual accounts and consolidated accounts. CPOSA is an oversight body that operates in compliance with the principles of legality, publicity and transparency.

The mission of CPOSA is to exercise effective supervision over the activity of the statutory auditors in order to provide high quality audit services. Its aim is to increase as a whole the confidence of the investors and the civil society in the information, included in the financial reports.

Our vision for the development of CPOSA is to continue its developing as a leading institution that contributes to the protection of the public interest and enhances investor confidence.

To achieve its mission CPOSA: Exercises supervision over the activity of the Institute of Certified Public Accountants (ICPA); Carries out quality assurance inspections of the activity of the statutory auditors, carries out investigations upon received signals on alleged irregularities and imposes penalties in cases envisaged by law; Cooperates with the respective authorities of the European Union, with supervisory authorities of the Member States of the European Union or of third countries which are responsible for the independent financial audit.

The Commission is a member of the European Group of Auditors' Oversight Bodies (EGAOB), the European Audit Inspection Group (EAIG) and the International Forum of Independent Audit Regulators (IFIAR).

The organizational structure and functions of the Commission are additionally regulated by the "Rules of Procedure" of the Commission for Public Oversight of Statutory Auditors published in the State Gazette of the Republic of Bulgaria.

According to the current legislation, all statutory auditors and audit firms, members of the ICPA, are subject to quality control of their activity. CPOSA exercises supervision over the quality of the work only of those auditors that carry out an independent financial audit of public-interest entities, which scope is determined by the Accountancy Act (AccA). The supervision of the rest of the statutory auditors and audit firms is carried out by the professional organization.

¹ The reference period is from 01.07.2015 to 30.06.2016

The Commission held 40 meetings in 2015/2016 during which were reviewed 192 topics: 142 of them were connected to the oversight of the activities of statutory auditors and the ICPA's activities, 6 - to international cooperation, 8 - to the adoption of internal documents, and 36 other topics.

Substantial part of the activity of the supervisory authority is focused on the quality of the performance of the audit engagements of the financial statements of the public interest entities, having in mind the importance of the latter to the society, due to the scale and complexity of their business or its character.

In light of this, the special provisions regarding statutory audit of public interest entities contained in Directive 2006/43 / EC are further developed in Regulation (EU) № 537/2014 of the European Parliament and of the Council and Directive 2014/56/EU amending Directive 2006/43/EC, in respect of which CPOSA undertook appropriate actions in order to prepare proposals for changes in the national legislation.

In pursuance of the above, the created working groups of the supervisory authority and the professional organization discussed all the relevant issues in order to transpose the requirements of the Directive 2014/56/EU and to regulate the measures for applying the Regulation (EU) №537/2014. On this basis, CPOSA and the Ministry of Finance jointly prepared a new draft of the Independent Financial Audit Act (IFAA), with which the new requirements of the European Audit legislation will be fully implemented.

In accordance with the requirements of IFAA and Directive 2006/43/EC in 2015, CPOSA fulfilled its obligations and implemented its powers of control over the quality of the work of statutory auditors through the implementation of planned, thematic inspections as well as performing a check of the implementation of the given recommendations. There were also other investigations conducted in response to received signals from stakeholders or following own-initiative.

In this context, the Commission is taking additional actions to improve the methodology associated with preparing and carrying out the inspections. A statistical model was approved and implemented for determining the boundaries of the standard deviation of the average amount of hours invested in audit according to economic sectors. It is based on the analysis of the information provided in the annual reports of the auditors towards 30.06.2015, concerning the hours for performing the audit engagements, reported by the statutory auditors or audit firms. For the purpose of the analysis it was assumed that factors like the net income and/or the amount of assets of an entity have a great influence on the hours spent on auditing.

During the reporting year, besides the effective use of the Standard for determining the sample of the audit engagements which should be reviewed, two new tools were tested in practice: the Instruction for assessment of the adequacy of time resources spent on audit engagements and the Instructions for assessing the adequacy of audit fees for each engagement. Both of these documents were prepared in 2014. They include procedures for assessing the

adequacy of the time resources spent and the received remuneration for conducting an audit. Their aim is to put into practice some objective criteria, to harmonize the actions of the inspectors, and to achieve sufficient justification at assessing the adequacy of the input of the time resources spent on audit and the audit fees received in relation to the interconnection of the complexity, nature and other specifics of a particular audit engagement.

The inspectors of the Commission fulfilled the plan for oversight activity and carried out 69 inspections for quality control over the activity of statutory auditors and 10 investigations (including thematic reviews), in response of received signals or at its sole discretion.

The results of the carried out inspections on the quality control of the provided audit services show that although the majority of the audit engagements comply with the main requirements, there are still identified a number of deficiencies in each of the different audit stages.

At the *Audit Acceptance and Continuance Phase*: where the auditor is changed, often there are not sufficient audit evidences about the communication with the previous auditor. Another common deficiency is that the Audit Engagement Letters don't meet all the content requirements as prescribed by the professional standards.

At the *Audit Planning Phase* there are deficiencies concerning the understanding of the internal control; deficiencies in determining the materiality levels to evaluate the effect of the identified misstatements on the audit and that of the uncorrected misstatements, if any, on the financial statements and on forming the opinion expressed in the audit report, incl. when choosing a basis for determining the appropriate levels and others.

At the *Audit Execution Phase* for first-year audit engagements there aren't checks for confirming the opening balances; when performing substantive procedures in many cases the audit tests do not cover all the key assertions and/or subjects of significance for the financial report. Most often the deficiencies are related to the confirmation of the income, expenses, cash, in assessing if impairment indicators exist for the assets, and in the evaluation of the management's approach to fair value measurements.

At the *Audit Completion Phase* there are often not checks performed for correspondence of the information given in the financial statements and in the annual activity report; communications with the appropriate level of management are not documented on topics regarding the discovered misstatements, deficiencies, irregularities and others.

During the reported year in CPOSA were filed 24 requests for investigation (signals), in comparison with 71 in 2014/2015, 8 of which referred to activities of statutory auditors and were related to the quality of the audit services and breaches of ethical requirements. The rest (16) were objections and complaints against decisions of the ICPA in connection with the acquisition of professional competence as a certified public accountant, and the registration as an independent auditor.

Having in mind the significant public interest and on the grounds of the above-cited provisions of the IFAA, CPOSA on its own initiative took the decision to carry out thematic inspections (investigations) of registered auditors who have audited the financial statements of banks and mandatory pension funds.

The inspection teams of CPOSA conducted 5 thematic inspections (investigations) about the performance quality of the carried out financial statement audits (annual financial statements for 2013) of the Universal Pension Funds and the Professional Pension Funds concerning their investments. There are 4 other thematic inspections (investigations) conducted in relation to completed audit engagements of Annual Financial Statements for 2014 of several banks. These were focused on equity, crediting, deposit activity and long-term funding, provisions and contingent liabilities.

The main infringements found during the carried out inspections (investigations) were related to the professional standards, the ethical requirements and the reporting of the activities of the statutory auditors to the ICPA.

This year a new Independent Financial Audit Act (IFAA) is coming into force. It transposes the new requirements of the European Audit Legislation - Regulation (EU) № 537/2014 of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities and Directive 2014/56/EU amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts.

The main priorities of CPOSA are influenced by the fact that the new IFAA will extend the CPOSA's regulatory powers as the competent authority for public oversight of statutory auditors.

First, the timely preparation and adoption of domestic legislation is still pending about the rules and procedures regarding: the conduct of examinations for obtaining a license for a certified auditor, the continuing professional development, and the quality control of the statutory auditors to which a new approach will be introduced, in accordance with the size of the audit practice. A priority will be to draw up methodologies for conducting joint audits and for evaluation of the performance of the audit committees, which will be one of the new duties of the commission imposed by Regulation (EU) № 537/2014 of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities.

Secondly, in order to improve the tools for quality control of the audit activities a new set of questionnaires for conducting the inspections will be developed that will take into account the different size of the audit practices. During its work, CPOSA concluded that the current questionnaires, which are applied to all auditing practices, do not give enough possibilities for achieving a better efficiency of the inspections, because of the lack of such a differentiation. Drawing up and implementing a separate questionnaire for inspections of credit institutions proved to be a good practice, due to their specifics as public-interest entities. This approach will be also applied in regards of the pension funds and the insurance companies. The use of such

specific questionnaires suggests higher efficiency and objectivity of the inspections for quality control of the audit activity.

In order to enhance the effectiveness of the oversight activities, CPOSA will take actions, according to its budget, for increased use of automation and management of data of the inspection activities (i.e. by using electronic tools for verification and processing of the data).

Another important priority for CPOSA not only for this year, but also for the forthcoming ones, is and will be the further development of professional and personal skills of the employees, who are performing the oversight activities of CPOSA. The system for internal quality control of the inspections performed will continue to be used, too.

Finally, CPOSA will continue to work for a broader application of the risk-based approach in carrying out the supervisory activities. The created Unit for risk assessment and market monitoring of the audit services will create and maintain a permanent record of files for the statutory auditors, which will contain information about media publications related to this auditor, the results of the quality control of the auditors' practice, data about the sanctions, information concerning "risky" clients, record of received reports and complaints regarding the work of the auditor. The aim of this approach is to support and make more effective the implementation of the oversight activities of CPOSA.

23.06.2016

Изготвил:
Стойчо Михов
Старши експерт АОР