

ANNUAL REPORT OF THE COMMISSION FOR PUBLIC OVERSIGHT OF STATUTORY AUDITORS' ACTIVITIES FOR 2016/2017¹ – SUMMARY

The Commission for Public Oversight of Statutory Auditors (CPOSA) is a specialized governmental body that regulates and oversees the professional activity of the statutory auditors. In relation to this, CPOSA exerts oversight over the activities of the Institute of Certified Public Accountants (ICPA)², regarding the tasks delegated to it by CPOSA. The Commission for Public Oversight of Statutory Auditors also assesses the performance of the audit committees, as well as the market concentration levels, including in specific sectors. CPOSA is an independent authority, a legal entity on budgetary funding. The chairman and the members of CPOSA are appointed by the National Assembly. CPOSA is established in 2008 by the Independent Financial Audit Act (IFAA) in compliance 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 reports annually its activities to the National Assembly.

In order to ensure effective independence from undue influence in its regulatory functions, and in accordance with its legal powers and responsibilities, CPOSA independently plans and carries out its activities. It also observes that the funding for its inspection activity is adequate, sufficient and independent from the supervised registered auditors.

The mission of CPOSA is to exercise effective supervision over the activity of the statutory auditors, so that they 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.

The organizational structure of CPOSA and its functions are regulated both by the “Independent Financial Audit Act” (IFAA) and the “Rules of Procedure of the Commission for Public Oversight of Statutory Auditors”, which are published in the State Gazette of the Republic of Bulgaria. The 2016 State Budget Law of the Republic of Bulgaria stipulates that CPOSA shall have a total of 28 employees, who are organized in two Directorates (“Oversight Activity Directorate” and “General Administration Directorate”), or are directly subordinate to the Chairman.

At the end of 2016 the new IFAA was adopted. It transposed into the Bulgarian legislation the requirements of Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts. It also introduced some new rules concerning the implementation of Regulation (EC) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities.

¹ The reference period is from 01.07.2016 to 30.06.2017

² The Institute of Certified Public Accountants (ICPA) is the single national professional organization for all Certified Public Accountants in Bulgaria

The new IFAA was prepared jointly by the Ministry of Finance, CPOSA, and the ICPA.

Prior to the entry into force of the new IFAA, the delegated to ICPA tasks (concerning the organizing and conducting the examinations for acquiring legal capacity as a statutory auditor; continuing professional development; keeping and updating the register of the auditors/audit firms in Bulgaria) were carried out in accordance with the rules and procedures drawn up and adopted by the Managing Board of ICPA.

In compliance with the requirements of the IFAA, CPOSA exercises its supervisory powers through conducting of planned or thematic inspections, as well as performing a review of the implementation of the given recommendations. It also carries out investigations on alerts by stakeholders or at its own discretion.

The audit quality control inspections include review of the compliance with the requirements of the ISAs, as well as with the ethical and independence requirements. They include also an assessment of the internal quality control system, of the adequacy of the time spent for audit, the used human resources and the received audit fees. Additionally, CPOSA performs a review of the implementation by the auditors of the recommendations given to them on previously identified deficiencies and inconsistencies. It also performs a check for compliance with other legal requirements.

In carrying out the inspections (although a larger part of the inspected audit practices meets the essential requirements), a number of weaknesses have been identified that outline problem areas regarding the adherence to the professional standards (IFRS, ISAs and ethical standards). These areas are similar to those identified in previous years: there are deficiencies in the analysis of the sector-specific accounting practices and regulations, as well as of the fair values accounting; there is no communication with the previous auditor; the audit engagement letters do not meet the requirements of the professional standards; there are deficiencies in the understanding of the internal control e.g. procedures for assessing the risks of fraud and material misstatement of the report are not performed.

The results of the inspections often indicate: discrepancies between the information in the financial statements and the data in the annual activity report of the audited entity; deficiencies in the disclosure of related party transactions are also very common; errors and/or deviations, cases of non-compliance with statutory or regulatory requirements identified by the audit have not been discussed with the management of the audited entity; the form and the content of some audit reports are not consistent with the legal requirements;

The results from the inspections also show a few cases of: deficiencies in planning, documenting and reporting the hours spent for an audit; lack of validated and objective criteria concerning the price formation of the provided audit services; creating prerequisites for unfair competition in the audit services market by offering unfairly low prices.

The inspectors of CPOSA fulfilled the plan for oversight activity and carried out 64 inspections for quality control over the activity of statutory auditors³. From 1st May 2016 until

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30th June 2017 were conducted 2 thematic reviews and 16 investigations, in response to received signals or at CPOSA's sole discretion.

As a result from the carried out inspections and investigations, 18 acts were established for administrative infringements – 17 were penal decrees for the imposition of fines and property sanctions, the other one was a notice of violation to a certain statutory auditor concerning minor breaches under Article 28, letter “A” of the Administrative Violations and Penalties Act.

Of these 17 penal decrees 8 are currently in appeal proceedings, while the rest are already legal binding.

With the entry into force of the new Independent Financial Audit Act (which transposed the requirements of the European Audit Legislation) at the end of 2016, the priorities of CPOSA are as follows:

First, to continue with the process of developing and adopting internal documents regulating: the conduction of the examinations for acquiring legal capacity for a statutory auditor; the continuing professional development; and the quality control of the registered auditors by using a differentiated approach depending on the size of the audit practice. Another priority is to continue the work on developing a methodology for evaluation of the performance of the audit committees, as this is one of the CPOSA's new responsibilities under Regulation (EU) No 537/2014/EU.

Next, in order to increase the efficiency of its supervision, CPOSA shall continue to improve the tools applied as part of the inspection process e.g. using more electronic tools for the sake of improving the analysis and data processing system.

In connection to its duties (imposed by the Regulation (EU) No 537/2014/EU) regarding the marker monitoring of the audit services, CPOSA intends to develop a special “Unit for risk assessment and market monitoring of the audit services”.

CPOSA will continue to work for a broader application of the risk-based approach (more thematically focused approach) in carrying out the supervisory activities. The main focus will be on the more significant public interest entities and audit firms.

Another important priority for CPOSA remains the further development of the professional and personal skills of the employees, especially of those who are performing the oversight activities of CPOSA. The system for internal quality control of the inspections performed will continue to be used.

Finally, CPOSA will continue its fruitful cooperation with the professional organization (ICPA) by supporting its initiatives that promote a better audit quality.