



Commission for Public Oversight of Statutory Auditors

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ROUND TABLE
**THE ROLE OF PUBLIC OVERSIGHT AUTHORITIES FOR ENSURING
BETTER PROTECTION OF PUBLIC INTEREST**

On 19th May 2009 the Commission for Public Oversight of Statutory Auditors conducted a round table “The Role of Public Oversight Authorities for Ensuring Better Protection of Public Interest” with international participation. Representatives of the European Commission, World Bank, National Assembly, Financial Supervision Commission, Institute of Certified Public Accountants and big audit firms took part in the event.

Meeting public expectations

Dr Nikolay Chatalbashev,

Chairman of the Commission for Public Oversight of Statutory Auditors

Dear guests, dear colleagues,

Ladies and Gentlemen,

The objective of this round table is to discuss the opportunities to raise the audit service quality and to ensure the reliability of financial information thus assuring better protection of public interest. The ENRON, PARMALAT, MADOFF and STANFORD cases made the auditor profession face serious challenges. Not underestimating nor belittling its capacity of self-regulation, the necessity of external independent assessment of auditing quality stands to reason. Public oversight should

answer the expectations of investors, shareholders and society to guarantee the reliability of financial information and to recoup the trust in audit profession.

Actually, today we continue the discussion started at the VI-th congress of ICPA at the end of the last year when the focus was on the auditor's liability i.e. ICPA's liability. Now, I propose to concentrate our ideas on the responsibility of the Commission for public oversight of statutory auditors for protection of public interest.

I use the chance to brief you on what the Commission has completed for the 6-month period from its establishment. The Commission drafted and issued Regulations for the Activity of CPOSA where the structure and functions of its administration are defined. Other internal normative documents necessary for the functioning of the Commission as an independent administrative body were adopted.

Appropriate financial resources were secured together with the necessary material foundation and equipment. After a competition the inspectors responsible for quality control were recruited. The Commission adopted a specialized inception training programme for the newly-appointed inspectors. In the course of 10 weeks they had been preparing and passed exams in International accounting standards, International standards on auditing and the requirements concerning public oversight.

The Commission discussed and approved the following documents proposed by ICPA:

- Rules for organisation and conducting the candidates' exams for acquiring legal capacity as a certified public accountant;
- Rules for conducting continuing training of certified public accountants and statutory auditors;
- Methodology for defining the amount of working hours appropriate for completion of the independent financial audit;
- Code of professional ethics, Status of non-staff inspectors, Rules for web-site disclosure of the activity of the Commission was also adopted.

The Commission adopted its 2009 Annual Working Programme where the approved priorities are: institutional development, administrative capacity building, oversight activity, cooperation with the EC bodies and EU member states, ensuring transparency and publicity of the activity of the Commission. It is due, the Annual Programme for Quality Control and the Budget necessary to be developed together with ICPA.

For the last 6 months the Commission has held 12 sessions and has discussed 64 issues. At its recent meeting it made a decision for performing 9 pilot inspections for probing both the rules and procedures for quality control on auditing services and the questionnaires used. Among the sites of pilot inspections are Ernst & Young, Sofia Financial Accounting Company, Suflin, Ivas Consult etc. We laid the foundations of good cooperation with ICPA, Financial Supervision Commission and EGAOB. Chairman and the members of the Commission took part in the VIth Congress and General Assembly of ICPA. Two joint sessions of the Commission and Managing Board of ICPA took place and on 5th June there will be a third one, focused on the quality control on auditing services. We also had a meeting with Financial Supervision Commission where we decided to exchange information on the cases of non-observance of auditing standards.

From December 2008 we regularly participate in the activity of EGAOB. Chairman and the members of the Commission took part in the plenary sessions and the work of sub-groups on ISAs and on cooperation within EU and with third countries. The meeting with Mr Hans van Dam, chairman of the European Federation of Accountants was also interesting and useful. We invited Mr Volker Roericht, Chairman of German Auditor Oversight Commission, and Mr Tim Volkmann, Secretary General, to introduce good practice of oversight activity in Germany to our staff.

We evaluate the work completed to the moment as a good start of our activity, that is to be enlarged and strengthened. We render an account of the serious problems

we should further solve – qualification of the inspectors, organization and effectiveness of the quality control on the auditing services, development and mastering of good practices in oversight activity, applications of specialized information system, efficient cooperation with oversight bodies of EU countries.

We should give answers to the questions: are 600 statutory auditors many or few for Bulgaria; is their capacity being used; what is the trend of taking engagements between audit firms and statutory auditors; what are the most common and essential infringements of the requirements of ISAs, etc.

Ladies and Gentlemen,

I am delighted to point out that with our Independent Financial Audit Act all basic requirements of Directive 2006/43/EC have been transposed and Bulgaria ranks among the 17 member states to meet this pre-condition. We have an independent oversight body with correspondent powers and responsibilities.

To fulfil its designated duties the Commission has planned the following:

- to continue the active cooperation with ICPA;
- to strengthen international cooperation for research of experience and good practices;
- to use new forms and sources for the increase of professional qualification of inspectors, including international programmes and EU programmes;
- to improve the legal framework and if necessary to give argued proposals for amendments in the Independent Financial Audit Act.

These ideas can be subject to discussion now or at a future meeting where we will present a strategy for the future development of public oversight of auditing activity. The Commission relies on publicity and transparency of its activity by means of its website.

EC policy for public oversight of the auditors – legal framework and requirements

Mr Jurgen Tiedje,

Head of Auditing Unit in DG "MARKT" of the European Commission,

Mr Tiedje spoke about the EU legal framework with respect to the establishment of independent public oversight and external quality assurance systems in the EU Member States based on the provisions of the Directive 2006/43EC of 17 May 2006 on statutory audits of annual accounts and consolidated accounts and on the Commission Recommendation of 6 May 2008 on external quality assurance for statutory auditors and audit firms auditing public interest entities.

The presentation focused on four main points: professional judgement, independence of public oversight systems and of inspectors, co-operation at EU and international level and transparency, as follows:

1. Professional judgement

Auditing is about human capital, well trained people who are capable to face difficult situations. The role of an auditor is to minimize material risk in financial statements. To fulfil this task, a good auditor does not just follow procedures; he uses his professional judgement based on sound principles to address risk of possible frauds and risk of errors in financial statements. Compliance with ISA is an important part of auditor's work, but it does not replace the professional judgement or other parts of audit regulation, such as independence.

The EU Commission intends launching a public consultation on the introduction of ISA in the EU, in June 2009. At the same time, the EU Commission will publish the

results of the cost-benefit study on the introduction of ISA.

2. Independence of public oversight systems and of inspectors

Traditionally, professional bodies carried out inspections of auditors and audit firms in Member States. Following the adoption of the Directive on Statutory Audits, public oversight bodies must have the ultimate responsibility for the oversight of the approval, registration, continuing education of statutory auditors and audit firms, the adoption of standards on professional ethics, internal quality control of audit firms, the quality assurance, investigation and disciplinary systems of statutory auditors and audit firms. As a consequence, the public oversight bodies must play an active role. In the Member States where certain tasks of the public oversight body are delegated to the professional body, the public oversight body should give instructions to the professional body with respect to the manner in which such tasks need to be fulfilled. It is not the professional body, but the public oversight authority which will hold accountability for wrongdoings by auditors.

The Commission Recommendation on external quality assurance clarifies the concept of "ultimate responsibility". It comprises provisions requiring the public oversight body to take the lead on inspection methodology, assignment of inspectors, follow-up on inspections, inspection reports, instructions to professional bodies.

The Commission Recommendation distinguishes between auditors of public interest entities and auditors of other entities. It provides guidance for implementing independent quality assurance systems for statutory auditors and audit firms conducting an audit of public interest entities.

An important challenge for the public oversight bodies of Member States is finding

the appropriate staff to carry out inspections of statutory auditors and audit firms. Such persons should be independent from the profession, but should, in general, have appropriate professional experience in an audit firm. It would be useful to have in an inspection team persons who carried out audits of companies.

Currently, the public oversight bodies in Finland, Netherlands, Sweden and United Kingdom employ inspectors that meet these criteria. In France and Germany, the inspectors have been recruited by the professional body, but they work under the instructions of the public oversight body and they are independent inspectors with experience in an audit firm.

Another model consists of having practitioners selected as peer reviewers. A third model consists of designating the professional body to carry out the quality assurance reviews of statutory auditors and audit firms, under the oversight of the public oversight authority.

3. Co-operation at EU and international level

Because of the international dimension of auditing, public oversight bodies, like other financial services regulators, must co-operate. The international aspect of auditing is reflected in the existence of networks and the group audits. One should just count the number of countries in which the Big Four are present (more than 130 countries).

Under the Directive on Statutory Audits, there is a need for independent inspectors in the EU Member States, as co-operation on the oversight and inspections of auditors might be rendered difficult by the refusal of public oversight bodies to

co-operate with professional bodies. The trend of having independent inspectors in the auditing field is supported by banking and securities regulators, the Financial Stability Board and the large four professional networks.

It is essential for public oversight bodies to co-operate as, otherwise, there might be a situation where other regulators might intervene and take over their tasks (for example, banking regulators or securities regulators).

At the EU level, the public oversight bodies of Member States co-operate in the framework of the European Group of Auditor Oversight Bodies. This is currently a consultative group where Member States' public oversight bodies meet on a regular basis under the chairmanship of the EU Commission.

At international level, public oversight bodies from more than thirty countries co-operate within the International Forum of Independent Audit Regulators.

4. Transparency

Transparency enhances the accountability of the public oversight and the audit profession. Transparency should exist at different levels: during the recruitment process of inspectors, in relation to the activities of the public oversight bodies, the inspection program and the outcome of the inspections of individual statutory auditors and audit firms.

The Commission Recommendation on external quality assurance underlines the need for transparency throughout the external quality assurance system. It recommends

that the public oversight body communicates and discusses with the inspected statutory auditors and audit firms the inspection findings and the conclusions on which recommendations are based, before an inspection report is finalised.

In addition, the Recommendation invites Member States to draft an annual report on the results of the quality assurance system. Such report should include information on recommendations issued to the inspected statutory auditors and audit firms, follow-up on such recommendations, disciplinary actions taken and penalties imposed. It should also include quantitative information and other key performance information on financial resources and staff, and the efficiency and effectiveness of the quality assurance system.

According to the Recommendation, the public should be informed by the public oversight body in a timely and appropriate manner about any final disciplinary actions taken or penalties imposed in respect of statutory auditors and audit firms in relation to the execution of the statutory audit.

5. Conclusion

Legal provisions are not sufficient for a high quality audit. The professional judgement of the auditor plays an essential role in the audit process.

The independence of the public oversight bodies of Member States is a key element in ensuring an effective and efficient public oversight on statutory auditors and audit firms.

At present, the necessary co-operation between public oversight bodies at EU and international level due to the existence of large audit firms with big networks leads

towards a need for independent inspectors to carry out quality assurance reviews of statutory auditors and audit firms.

Transparency brings benefits to the profession: more confidence in the audit profession and better accountability.

Working Together to Enhance Financial Reporting

Supporting the effective implementation and enforcement of the *acquis communautaire*

Mr John Hegarty,

*Head of the World Bank Office in Vienne and the Centre for
Financial Reporting Reform in Europe and Central Asia*

Mr John Hegarty presented the Programme of the Bank for Supporting Financial Reporting and implementation of the International Standards of Auditing in the new member states, having accessed the EU after 2004.

“Sound financial reporting is an essential condition for market economies to work properly”, said European Commissioner Charls McCreevy at the opening of the World Bank Centre for Financial Reporting Reform in Vienna. “Improving the quality, comparability and transparency of the financial information is crucial for the Internal Market, as well as for strengthening economic links between the EU, candidate and potential candidate countries, and other third countries”.

The establishment of the Centre is an important milestone in the World Bank's work that emphasizes its commitment to the strengthening the financial reporting standards in Europe and Central Asia. "We have come a long way in our work towards creating an appropriate framework for financial reporting and auditing, but there is more to be done", underlined Mr McCreevy in his speech. "This goes for national implementation, as well as our joint efforts to come to global financial standards. We are thankful for the commitment of the World Bank to support countries in their moves towards closer integration with the EU and towards better financial reporting. We very much welcome the contribution of the World Bank to promote the use of international standards on auditing in the Member States that joined the European Union after 2004. The work of the World Bank greatly contributes to the effective implementation and enforcement of the EU acquis, in particular with respect to public oversight and external quality assurance systems."

For supporting the efforts of the new Member states for implementation and enforcement of the *Acquis communautaire*, the World Bank and Centre for Financial Reporting Reform have developed a special programme for providing technical assistance.

The need for the program can be summarized in the followings:

- High quality financial reporting is not just a question of legal compliance, but an essential underpinning for cohesion and competitiveness in the Single Market;
- Responding to the financial crisis;
- Extensive legal and regulatory reform as part of the EU accession process, to comply with the relevant *acquis*;
- Further strengthening of institutional and human capacity required for effective implementation and enforcement;
- The *acquis* is a moving target with tight deadlines;

- Financing gap.

The overview of the Program can be described as:

- Activities at both national and regional level;
- Complement interventions at Member State level with joint activities to develop; common responses to common challenges and exploit synergies;
- Reinforcement, not replacement of Member State involvement in EU-level discussions and activities;
- Facilitation of a speedy replication of good practices developed elsewhere;
- Flexible programmatic approach to be implemented through:
 - » General framework;
 - » Annual work programs.

The Key features of the program to be conceived are:

- Financial assistance under the Swiss Enlargement Contribution;
- Member State ownership and leadership;
- Comprehensive multi-year program, rather than fragmented individual projects;
- Robust results framework, monitoring, evaluation;
- Synergies of multi-country approach;
- Structured exchange of information between the new Member States;
- Continuing policy dialogue with the European Commission;
- Policy and capacity partnerships with EU and global bodies;
- Integration of policy development, program design and implementation, financing and accountability to the Member States.

The Assistance from the World Bank shall include:

- Support to Member States with the identification of needs and with program design and documentation;
- Program delivery and implementation, including:
 - » Organization and supervision of overall program;
 - » Leveraging of multi-country synergies;
 - » Mobilization of in-kind contributions from partner bodies;
 - » Direct delivery of certain program activities;
 - » Procurement, supervision and payment of national and other consultants charged with delivery of other program activities;
 - » Administrative organization of program events (distance learning, workshops, conferences, seminars, etc.);
 - » Administration of program knowledge management activities (research, website, publications, distance learning);
 - » Monitoring and evaluation;
 - » Progress reporting to Member States, and assistance with the Member State by reporting to SECO and the European Commission.

The menu of activities to be supported comprises of:

- Establishment of a public oversight system;
- Public oversight systems (CoP);
- Establishment of a quality assurance system;
- Quality assurance systems (CoP);
- Adoption and implementation of International Standards on Auditing;
- Public register of auditors and audit firms;
- Enforcement of IFRS;

- Financial reporting by listed companies (CoP);
- Financial reporting in the insurance sector (CoP);
- Financial reporting in the banking sector (CoP);
- Financial reporting by SMEs;
- Relationship between taxation and accounting;
- Public availability of financial statements;
- Financial aspects of corporate governance (CoP);
- Education and training reform (CoP);
- Knowledge management (website, GDLN);
- Program management, monitoring and evaluation.

The Programme has its Focus on public oversight and Quality assurance through the following envisaged activities:

- Advice on administrative and organizational structures for oversight systems;
- Induction training and familiarization for new oversight system members, including peer learning programs with equivalent bodies in other Member States;
- Assistance with development of administrative procedures and information systems;
- Support for the development of oversight methodologies and reporting approaches;
- Facilitation for the structuring of the relationship between the oversight system and audit quality assurance functions of professional organizations;
- Development of quality assurance methodologies and work-flow management systems;
- Training for those responsible for carrying out quality assurance;
- Peer learning events with those responsible for quality assurance in other Member States;

- Training on IFRS, auditing, and auditing standards and practices for oversight system members and for those responsible for quality assurance;
- Training on ISQC 1 for oversight system members, for those responsible for quality assurance, and for audit firms;
- Facilitation of lessons-learned dialogue between oversight systems, those responsible for quality assurance, professional bodies and practitioners.

The World Bank and the Centre consider as Partners for the progress of the Programme the below listed:

- European Commission
- Federation des Experts Comptables Europeens (FEE)
- Major national professional bodies
- Lamfalussy Committees
- European Group of Audit Oversight Bodies
- CFA Institute and national member societies
- International Federation of Accountants (IFAC)
- IAASB
- IESBA
- International Accounting Standards Board (IASB)
- International Forum of Independent Audit Regulators (IFIAR)
- Monitoring Group organisations (Basel Committee, IOSCO, IAIS, FSF)
- Common Content Initiative
- IMF, etc.

What are the next steps to be undertaken?

- Switzerland has already committed to extending the Enlargement Contribution to the 2007 new Member States;

- Bilateral Framework Agreement negotiations expected to commence in Summer 2009;
- If considered desirable, need to ensure that provision is made for a Financial Reporting TA Project;
- Need for lead counterpart / implementing agency to interact with Bulgarian negotiators, NCU and WB Vienna Centre;
- Work to begin without delay on preparing the Project Outline and subsequent Project Proposal, to facilitate rapid move to implementation and synergies with existing program in other new Member States;
- Possibility to participate in certain activities in the meantime, at own expense.

Discussion

In the follow-up discussion representatives of different institutions united their contributions around some key issues:

- Special attention was paid on the different models and approaches in structuring audit oversight activity in different member states. It was recognized that the Bulgarian model is a very successful one.
- The requirement of a professional level of audit activity was emphasized. Only well-prepared auditors can perceive the early signs of a crisis or other negative phenomena. Diagnostic audit should have the priority.
- Independence is to be associated with the execution of certain auditors' functions and the responsibility they have towards society, especially in a period of crisis, along with respect of law, accountancy standards, rules and procedures.

- Cooperation among the institutions is crucial – Commission for Public Oversight of Statutory Auditors, Institute of Certified Public accountants, Commission for Financial Supervision and National Audit Office. Cooperation and relations with similar organizations from member states are important to the Commission because of the opportunity to share experience on the quality control of audit activity.
- Searching for and reaching the reasonable balance between the public oversight and self-regulation was strongly discussed.
- The debate on the fair value of assets is still on the agenda.
- Global changes require attention not only on the micro indices but gathering of micro- and macro-indices in a single picture.

PRACTICE OF THE COMMISSION FOR AUDIT OVERSIGHT IN GERMANY

On 15th and 16th June 2009, Mr Volker Rohricht Ph.D., Chairman of the German Audit Oversight Commission, and Mr Tim Volkmann, Secretary General of the Commission, paid a two-day visit in Sofia at the invitation of the Chairman of the Commission for Public Oversight of the Statutory Auditors. They presented to the Commission and the inspectors the system of public oversight and rules and procedures for quality assurance of the statutory auditors' activity in Germany.

Dr. h.c. Volker Röhricht is actively involved in the independent public oversight of the German audit profession and serves since 2005 as Chairman on the German Auditor Oversight Commission (AOC). Until his retirement in 2005 Dr. Röhricht was Chairman of the 2nd Senate of the German Federal Court of Justice, the supreme court of appeal in civil and criminal lawsuits. The Senate he chaired is responsible for corporate law, capital market rules, corporate governance, and the correct application of statutory rules

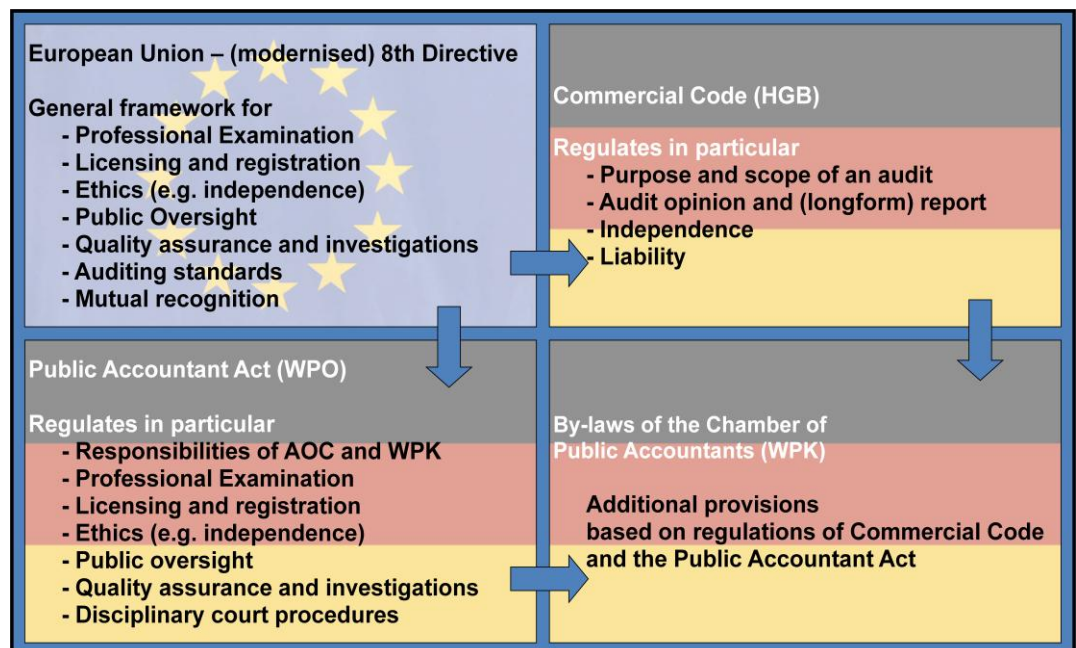
on accounting and auditing including questions of independence of statutory auditors. Dr. Röhricht is a public member of the International Ethics Standards Board for Accountants (IESBA, formerly the Ethics Committee) since 2005.

Dr. h.c. Volker Röhricht, Chairman of AOC, delivered a presentation on

The public oversight system for statutory auditors in Germany

Dr. Röhricht, outlined the legal framework for auditors and public auditor oversight and the structure of public oversight in Germany. He also shared the German experience from the initial phase of the auditor oversight commission, further practical Implications and lessons learnt.

The Legal Framework for Auditors and Public Auditor Oversight in Germany can be summarized in the following flow chart:

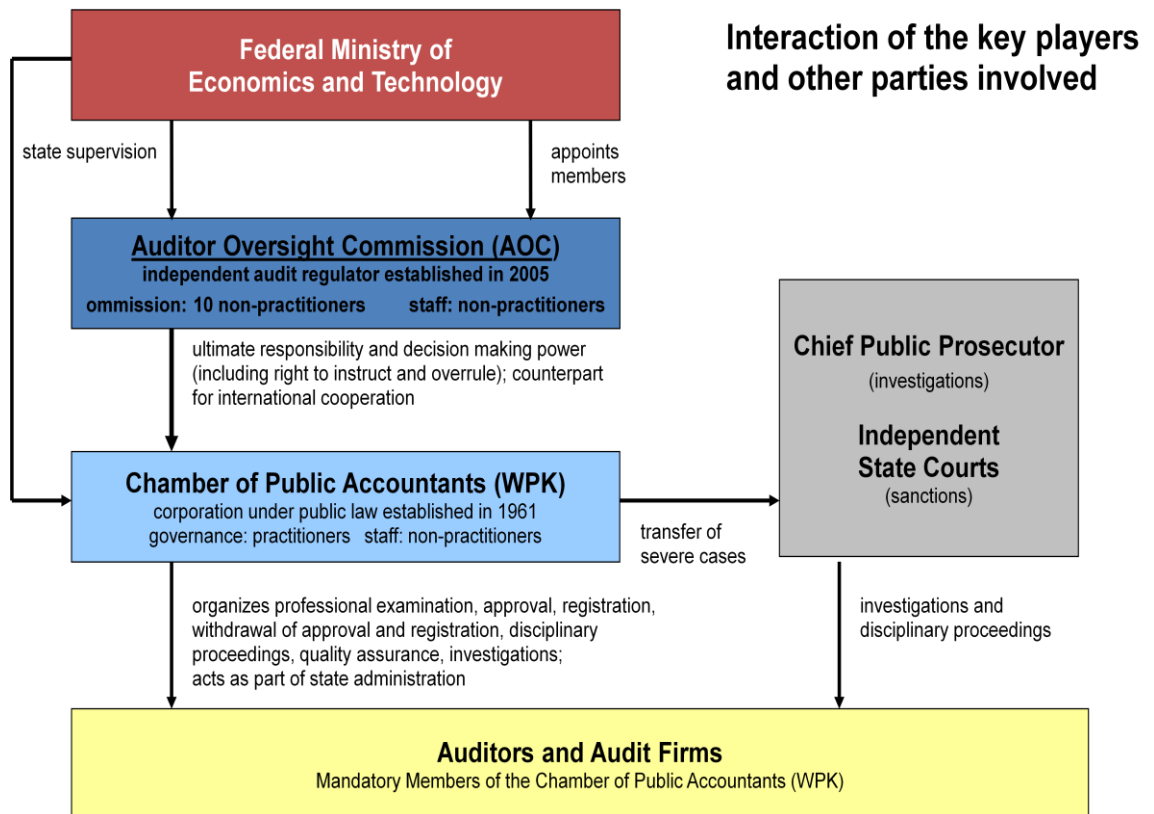


**The structure of public oversight in Germany covers its participating actors:
The Chamber of Public Accountants (WPK) and Auditor Oversight
Commission (AOC).**

The Chamber of Public Accountants (WPK), established in 1961 as a corporation under public law, is being governed by practitioners but staffed with non-practitioners. It organizes professional examination, approval, registration, withdrawal of approval and registration, disciplinary proceedings, quality assurance. The professional body carries out quality assurance procedures (monitored peer review) and - since 9/2007 - inspections (with its own staff). All its oversight activities are under close supervision and subject to approval by the AOC which holds the *ultimate responsibility*.

Auditor Oversight Commission (AOC) was established in 2005 to practice independent public oversight over the WPK and is being governed by independent non-practitioners. It holds the ultimate responsibility and decision making power regarding all auditor oversight activities thus having the right to access any information on oversight matters and to participate in any oversight activity. Although some tasks are delegated to the WPK, the ultimate responsibility remains with the AOC reserving to it the right to initiate procedures, instruct and overrule the WPK. **Auditor Oversight Commission (AOC)** is the counterpart for international cooperation.

This chart gives a functional picture of the structure of public oversight in Germany



The initial phase was characterized by the following formative processes:

- establishing internal rules and procedures (by-laws)
=> e.g. voting procedures, confidentiality, committees, objectivity/bias;

- familiarising with structures/procedures within WPK, both on a governance level and on a staff level
=> *imminent under the German oversight system where administrative and operative responsibilities still rest with WPK but the ultimate responsibility for all decisions made rests with AOC;*

- establishing committees
=> *for quality assurance and disciplinary procedures;*
- establishing rules for flow, contents and form of information from WPK to AOC
=> *AOC has access to all information in oversight matters and can request such information anytime from WPK; but the amount of information requires prioritisation to avoid an excess of information and distraction from relevant matters;*
- establishing independent staff support
=> *legal form prevents AOC from employing own staff; AOC can resort to staff of WPK; secretariat of AOC only accountable to the members of AOC;*
- seeking and establishing contacts with foreign counterparts
=> *e.g. CH FAOA, F H3C, NL AFM, US PCAOB, UK FRC;*

It can be summarized that practical implications could result from:

- the “clash of culture” moving from self-regulation to independent auditor oversight, i.e. the loss of ultimate responsibility for the profession
=> *requires sensitivity with regard to the self-conception of the profession and may result in lots of discussions;*
- discussions with WPK’s board and committees to coordinate their work
=> *requires proactive role of AOC in monitoring WPK’s operations and bodies;*
- the members of AOC being volunteers (vs. full-time)
=> *requires independent staff support / back office including experts for auditing/accounting;*

- the need to (re)affirm own rights and authorities
=> *as a result of disputes with the profession or ambiguities in the regulatory framework;*
- flaws in the regulatory framework
=> *constant need to consider improvements due to domestic flaws or changes in the global regulatory environment (e.g. EU Directives, European Commission Recommendations, expectations of foreign regulators with respect to recognition and “full” reliance);*
- the workload
=> *the number and complexity of procedures (quality assurance, inspections, investigations etc.) requires prioritisation; international contacts require a lot of time but are invaluable for reassessing, shaping and improving the own system.*

Lessons learned, shared by the Chairman of the German Audit Oversight Commission, can be considered very useful for the Bulgarian Commission, i.e.:

- the effects on the profession moving from self-regulation to independent public oversight should not be underestimated;
- the advantages of an cooperative approach with the professional body against confrontation should be considered;
- the workload, both on a domestic level and on an international level should not be underestimated;
- responsibilities should be prioritized; routine jobs (e.g. licensing) vs. main focus (e.g. quality assurance);
- the importance of an exchange with foreign counterparts, e.g. bilateral meetings, international conferences, EGAOB and IFIAR.

On 16th June 2009, **Tim Volkmann**, Secretary General of German Auditor Oversight Commission (AOC) met inspectors of the Commission.

Mr. Volkmann is Secretary-General of the German Auditor Oversight Commission (AOC) since its inauguration in 2005. From 1999 to 2005 he was working for the German Chamber of Public Accountants as Head of European and International Affairs. Since 2002 he serves as Technical Advisor to members of the International Ethics Standards Board for Accountants (IESBA), and is currently Technical Advisor to one of its public members, Dr. h.c. Volker Röhricht, former Presiding Judge of the Federal Court of Germany and Chairman of the Auditor Oversight Commission.

He presented:

Quality Assurance for Statutory Auditors in Germany

to the inspectors of Bulgarian Commission for Public Oversight of Statutory Auditors (CPOSA), representatives of Institute of Certified Public accountants and big audit firms.

The contribution was focused on three main points: overview on Quality Assurance system, the New Inspection System introduced in Germany in 2007 and the outlook for the development of the audit services quality assurance system.

Quality Assurance System in Germany

It involves:

- Monitored Peer Reviews, introduced in 2001 for *all* statutory auditors and audit firms. The reviews are performed by “peers” (i.e. practitioners)
- Independent Inspections, introduced in 2007 for statutory auditors and audit firms *of PIEs only*. The inspections are performed by staff of WPK (non-practitioners)

Both procedures are organised under the ultimate responsibility of the AOC and subject to close supervision.

The procedures of Monitored Peer Review requires the review report to be submitted to WPK for an assessment by WPK staff and the Quality Assurance Committee. The review report includes an opinion on the appropriateness and effectiveness of the internal quality control system, but does not refer to individual findings if not material with regard to the opinion. The reviewed audit firm receives a “certificate of participation”, required for appointment as auditor by companies. The certificate can be withdrawn in case of material shortcomings in the internal quality control system of the audit firm. AOC has ultimate responsibility for all decision taken and has the right to participate in any review.

Independent Inspections were introduced in anticipation of the EC Recommendation of 2008 on External Quality Assurance. The enhanced public interest and international acceptance of the German Oversight System required introduction of a more independent and more transparent quality assurance system for PIE auditors. The use of non-practitioners as inspectors (vs peers) is indispensable to safeguard the objectivity and credibility of the system. To ensure this, PIE auditors are subject to monitored peer review *and* independent inspections. AOC has ultimate responsibility including the right to participate in any inspection. Besides, AOC has influence on methodology, policies, procedures and the appraisal/handling of findings.

The New Inspection System affects auditors and audit firms of listed companies (PIEs). These are 130 audit firms in 2007 (144 in 2006) that have 800 engagements including about 1400 audits of financial statements (including group audits). About 70% of all relevant audit engagements are performed by “Big 5”(KPMG, PWC, Ernst & Young, Deloitte, BDO). The New Inspection System applies also to auditors and audit firms who audit companies from third countries listed in Germany.

The inspections are performed anytime on a sample basis and no indications for misconduct are needed. AOC is responsible for inspections and is especially entitled to initiate them. The AOC develops a plan of additional cycle considered for operational purpose depending on the number of audit engagements. Audit firms with 26 and more engagements are subject to inspection every year (approx. 10 firms). With 25 and less engagements are subject to inspection every 3 years (approx. 120 firms). This plan does not limit the AOC to just one inspection within such a cycle.

What does an inspection involve?

- Inspection and evaluation of the internal quality control system (whole firm review) with a focus on tone at the top, fees, partner remuneration, structure, policies, documentation, effectiveness etc.
- Inspection and review of selected audit engagements (engagement review). The focus is on compliance with professional rules (auditing standards, ethics including independence issues).

Inspections are performed by full-time staff of WPK (no involvement of practitioners). The staff outnumbers 11 inspectors by 31 December 2008 (16 inspectors in 2009). AOC issues a work plan to determine which firms will be inspected during the forthcoming year. The firms on the plan will be informed at short notice to reach „surprise effect“. The inspection begins with a request for relevant documents to facilitate a risk analysis and to determine which audit engagements are to be inspected („inspection plan“).

The methodology applied includes:

- instruments used: interviews, review of working papers and other documents and on-site inspections;

- auditors and firms are obliged to cooperate fully, i.e. to provide correct and complete oral information and any documents requested (fines in case of non-cooperation);
- confidentiality obligations waived by law; AOC and WPK including their staff subject to strict confidentiality;
- auditor's right to remain silent applies only to oral information, does not affect the obligation to provide documents;
- the right to enter and inspect premises and offices „anytime“, to inspect documents and to transcript or copy documents.

As an outcome of an inspection AOC receives draft report from the inspectors for approval. If deemed necessary AOC can demand additional inspection procedures to be performed. The findings on non-compliance with professional rules are presented to the AOC to consider the need for further investigations and/or measures by the Disciplinary Department. The findings on deficiencies in the internal quality control system are presented to the AOC to consider the need for further measures by the Quality Assurance Department. This can ultimately be leading to withdrawal of the certificate required to perform statutory audit. The private report on the findings is presented to the auditor or firm. Depending on the findings, actions may include call for remediation and/or sanctions. AOC publishes annual report on overall findings (anonymous basis).

First Results of Inspections in Germany

In 2008, 32 inspections were initiated; including two of the “Big Five” as in 2009 all the “Big Five” will be inspected. Some of the more frequent findings include:

- lack of documentation and consultation within the audit firm;
- lack of continuing education of auditors (particularly in the area of IFRS);

- training not specifically relevant to the particular field of work to which the auditor is assigned;
- partner remuneration based on generated profit rather than professional skills as dictated by the firm's process of promotion to partner;
- inadequate assessment and documentation as to whether independence requirements were met (i.e. when resorting to external auditors or experts)

The Outlook covers issues considering future improvements in the following areas:

- Direct operational responsibility of the AOC for disciplinary oversight and inspections of PIE auditors (at present: via WPK);
- Exemption of PIE auditors from peer review (at present: PIE auditors are subject to peer review and inspections);
- Extending the scope of inspections to all statutory audit *engagements* (at present: only PIE audit engagements);
- Conforming scope, methodology and reporting of peer review to inspections (at present: peer review focuses on internal quality control; no individual findings).