

COMMISSION FOR PUBLIC OVERSIGHT OF STATUTORY AUDITORS

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ANNUAL REPORT

2009

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DEAR LADIES AND GENTLEMEN,

Following art. 35e, para. 2, p.10 of the Independent Financial Audit Law, I present to your attention The Annual Report 2009 of the Commission for Public Oversight of the Statutory Auditors.

The year 2009 was the first full year of the functioning of the Commission and to this end the basic priority of the activity was its institutional building. The Commission started its operations with drafting and adoption of the internal normative framework, provision of appropriate material basis, recruitment and training of the employees. The effective internal organisation enabled timely start of the priority oversight activities of the Commission.

The Annual working programme was approved by the Commission. During the second half of 2009 the inspectors of the Commission together with the reviewers of the Institute of Certified Public Accountants accomplished the activities of the approved programme for audit quality control, covering the activity of 216 auditors and audit firms for the period June 2008 – May 2009. The most important task was to summarize the results and assess the quality level of the audit services nationwide.

Since December 2008 the Commission for Public Oversight of Statutory Auditors has been a member of the European Group of the Audit Oversight Bodies and since September 2009 of the International Forum of Independent Audit Regulators. This membership contributes to the enhancement of knowledge on good practices in the activity of the independent audit regulators and the rapid integration in the European system of the audit public oversight bodies.

The good start in the first year gives us the ground to claim that the Commission possesses the necessary administrative capacity basis to perform the tasks assigned with the Independent Financial Audit Law.

The main priorities of the Commission for 2010 are in relation to the requirements of the Directive 2006/43/EC regarding compliance with the standards of auditing and Auditors' Code of Ethics, the requirements of public information on the quality of audit services. The objective is to increase the confidence in the annual financial reports data, particularly in time of international financial crisis.

The Commission for Public Oversight of Statutory Auditors will work for building necessary capacity of the professionals and, if it is financially possible, for the enhancement of the international cooperation for exchange of experience, research and introduction of good practices. The goal is improvement of the working processes for more effective use of human and financial resources towards protection of public interest in the field of independent financial audit.

Dr Nikolay Chatalbashev

Chairman of CPOSA



CPOSA – the first meeting held on 25 Nov 2008, Chairman Dr Nikolay Chatalbashev (middle) and members (left to right Stoyan Malkochev, Hristina Simeonova, Dr Tzvetan Manchev, Dr Hristo Mavrudiev, prof. Ognyan Simeonov and prof. Dr Hristina Vucheva

1. Oversight of the Activity of the Institute of Certified Public Accountants

The main task of the Commission as a newly-established regulator was the approval of the basic audit oversight normative documents, as follows:

➤ *Rules for organizing and conducting the exams for acquiring certified public accountant competence.* The Rules provide the order and conditions for applying, preparation and conducting of exams for acquiring certified public accountant competence. They are aimed at assuring transparency and objectivity of the exam procedure and conditions for acquiring competence only by persons meeting the requirements of law.

➤ *Rules for continuing training of certified public accountants and auditors.* They regulate the order and forms of continuing training aimed at ensuring: sustained high quality qualification of certified public accountants and statutory auditors, adequate and effective training meeting the European standards; maintaining and enhancement of the quality of audit services.

➤ *Rules and Procedures for quality control over the activity of the statutory auditors.* They regulate the order for the completion of reviews on the compliance with the professional standards, regulatory and legal requirements for forming reasonable assurance that the audit reports issued are adequate to the specific circumstances. These rules aim sustained professionalism of statutory auditors as well as high level of public trust in the profession. Approving these rules the Commission recommended complimentary procedures to be worked out for identifying the adequateness of the time and human resources utilized.

➤ *Methodology for defining the amount of working hours, necessary for the performance of the independent financial audit.* It aims at ensuring high quality of audit services taking into account the nature of the business, its volume and number of staff of the audited entity; defining the applicable procedures for the performance of an engagement for an independent financial audit; to serve as a basis for defining the remunerations for the performance of an independent financial audit that are agreed between the client entity and the statutory auditors.

2. Quality Control over the Activity of Statutory Auditors.

Following the provisions of the art. 40c of the Independent Financial Audit Law during the first reviews of the quality of the activity of the statutory auditors, the control covered:

- Review of the audit documentation regarding compliance with the audit standards applicable;
- Review for compliance with the requirements of the International Audit Standards;
- Review regarding compliance with ethical principles and rules, including independence rules;
- Assessment of the internal quality control system, applied by the registered auditor.

Reviews for the audit quality did not cover the other two requirements of the law, i.e.:

- Ascertainment of adequacy of time and human resources, used for carrying out of the audit according to its scope and complexity;
- Ascertainment of adequacy of the auditors' remunerations for the audit;

Limitations in the scope of the reviews performed are due to the lack of methodology and criteria for assessment of the activity concerning these two indicators. These documents were supposed to be developed by the Institute of Certified Public Accountants. Based on the limitations the Commission accepts with some reserves the evaluation ranks given for the quality of audit services of the statutory auditors reviewed.

Results of all the reviews for quality of audit services.

In 2009 the inspectors of CPOSA took part in total 216 reviews for the quality of audit services, out of which 64 of auditors and specialized audit entities that had audited public interest entities. The audit engagements under review were completed in the period from 1st June 2008 till 31st May 2009 .

Reports on the results of the reviews of the activity of statutory auditors, having performed audits of PIEs, have been approved by CPOSA, the rest of the reports are approved by the Council for Quality Control of Audit Services at the ICPA.

Due to the reports approved, the following evaluation ranks were given after the quality control reviews:

- Evaluation rank „A” for 64 % of the practices reviewed;
- Evaluation rank „B” for 28 % of the practices reviewed;
- Evaluation rank „C” for 6 % of the practices reviewed;
- Evaluation rank „D” for 2 % of the practices reviewed.

Legend¹

Audit Planning. During the reviews of the applied procedures in planning the audit of financial statements it has been found that the necessary attention has not been paid when identifying all material key audit areas related to the timely solving of potential problems. This often results in the development of audit programmes that do not direct the audit team to the substantial work and testing of specific important audit areas is omitted.

Performance of Audit Plan. In the reviews of material procedures it has been found that audit tests do not cover all assertions. Testing is limited and material balances are not confirmed or are not looked through and consequences of detected errors are not analyzed.

The nature and scope of the performance of audit material procedures do not assure the compiling of enough and relevant audit evidences.

¹ Evaluation rank „A” – no substantial irregularities in the design and functioning of the quality control system and audit engagement performance
 Evaluation rank „B” with non-systematic substantial irregularities in the design and functioning of the quality control system and/or audit engagement performance
 Evaluation rank „C” with systematic substantial irregularities in the design and functioning of the quality control system and/or audit engagement performance ;
 Evaluation rank „D” with such an irregularity, that puts into doubt the design and functioning of the quality control system and/or audit engagement performance

Finalization of audit engagement. In the finalization of audit engagements the following irregularities were found:

- Reviews, concerning identifying and disclosure of connected persons and its record in the financial statement as well as follow ups after the date of the balance sheet, are not documented;
- Risk of material irregularities due to fraud were not assessed;
- No risk assessment of the outcome of a litigation on the future financial results.

Based on the review results and the identified material irregularities, correspondent recommendations for the improvement of activity of auditors have been given.

Statutory auditors have a 10-month term for undertaking measures due to the recommendations. After this term CPOSA will perform a follow-up control on the completion of recommendations and will publish the review results and the imposed penalties in case of non-completion.

3. International Cooperation

The Commission cooperates with the respective competent authorities from other EU member states with the purpose of exercising their powers in the sphere of public oversight of statutory auditors.

The Commission for public oversight of statutory auditors participates in the work of European Group of Audit Oversight Bodies, constituted following a decision of the European Commission dated 14th December 2005. Representatives of the Commission are members of two subgroups: on Intra-EU cooperation and Inspections Subgroup. In May 2009 in Sofia the Commission organized a round table on “The Role of Audit Public Oversight Bodies for Better Protection of Public Interest” with the participation of representatives of Audit Department of DG “Internal Market and Services” of EC.

In June, a delegation from the German Audit Oversight Commission headed by Dr Volker Roericht, Chairman, and Tim Volkmann, Secretary General, presented the experience of institutional development of the Commission, capacity building and methodology for reviews of quality control of audit services in Germany.

In November 2009 the Commission organized a second round table on „Quality Control on the Activity of Statutory Auditors: European criteria and practices” with the participation of a delegation of the French audit oversight body (H3C), headed by its President - Mrs. Christine Thin, representatives of EC and the audit oversight body of Greece.

In December a 5-day workshop on the audit quality control was organized together with the Institute of Certified Public Accountants. Lecturers from ICAEW, presented the structure and management of the Institute, and their experience in the field of quality assurance reviews.

In September 2009 the Commission for public oversight of statutory auditors become a member of the International Forum of Independent Audit Regulators that was established in 2006 and has a membership of bodies from 34 states. Its main activities are:

- Exchange of knowledge on the markets of audit services and practical experience in the activity of the independent audit regulators with a focus on quality control of the activity of auditors and audit firms.

- Cooperation and regulatory activities.

In the reported period no requests were filed and no information was provided to this point, connected to the audit oversight of the statutory auditors on behalf of the oversight bodies of EU member states or third countries.

4. Publicity and transparency of the activity

Significant efforts were made for assuring publicity and transparency in the activity of CPOSA. This raised the public trust in the institution and the activity of statutory auditors.

CPOSA's internet site, meeting the publicity and transparency requirements, helps clearly and completely to trace the planned and completed activities. The structure of informational materials has been developed following modern trends of access and user-friendly information environment. Information is thematically and logically structured. Data on review results, annual programme, annual report, statements and decisions of the Commission, trainings and presentations, legal framework, international relations and cooperation, news, press releases and press interviews are published regularly.

II. Institutional Building and Administrative Capacity

1. Organizational Structure

In 2009 the Commission has held 25 meetings, were discussed 149 questions , including 37 issues concerning the oversight of the Institute of Certified Public Accountants and the statutory auditors; 45 – assessment of the quality of audit services; 20 – international cooperation; 18 – adoption of internal acts; 10 – human resources; 7 – financial assurance and 12 others.

In performing its functions and powers the Commission is supported by general and specialized administration, structured in directorates.

- “Quality control on the activity of statutory auditors” directorate with 14 full time and 5 part-time inspectors.
- ‘Methodology and International relations” directorate with 5 employees.
- „General administration” directorate with 8 employees.

2. Human Resources

In the recent year the main task of the Commission as a newly-established structure was the recruitment and training of experts to work in the specific field of oversight of statutory auditors.

In February after a competition 16 inspectors were employed all with master degree in Economics, three of them have a second master degree in Law. Most of them possess professional experience in the sphere of Economics and Accounting.

The Commission has approved a special Induction training programme ending with passing exams on the basic topics: regulatory requirements of the oversight, international accounting and auditing standards; assessment criteria and indicators for the activity of statutory auditors. Five pilot reviews were organized for gaining practical experience in the assessment of quality of audit services.

Very useful for the professional preparedness of the inspectors was the experience of the colleagues from Germany, France and Greece, as well as the 5-day training with lecturers from England.

3. Budget

The total amount of Commission's budget for 2009 was 1 349 491 BGN, including the expenses for acquisition of tangible and intangible assets.

III. Priorities in the Activity of the Commission for the period 2010 – 2012

Among the priority tasks of CPOSA for 2010 and the following years are:

➤ Proposals for amendments in the national legislation, aimed at implementing the European directives that are in process of elaboration and modification.

➤ Pursuing a balanced approach to regulation, taking into account the benefits and costs associated with regulations;

➤ Inspections and investigations of complaints and warnings related to the activities of ICPA and registered auditors;

➤ Active cooperation with Bulgarian National bank, Commission for Financial Supervision, National Revenue Agency and other bodies having respect to the independent audit, by improving information exchange and coordination of supervisory activities.

➤ Effective cooperation and exchange of information with regulators authorities of EU Member States and IFIAR. Active participation in EGAOB meetings and its work groups. Maintaining close cooperation with the regulatory authorities of neighboring countries and third countries with which Bulgaria has increased the exchange of financial services including agreements on cooperation and exchange of information.