



**AUDIT PUBLIC OVERSIGHT  
COUNCIL**

**REPORT ON ACTIVITIES  
OF THE AUDIT PUBLIC OVERSIGHT COUNCIL  
IN 2011**

## **INTRODUCTION**

The Audit Public Oversight Council (hereinafter referred to as “the Council”) was established in May 2009 in accordance with Act No. 93/2009 Coll., on Auditors, and the amendment to certain other legislation (hereinafter “Auditor Act”).

The Council is a public oversight body for the proper performance of audit activities, which is superior to all statutory auditors and audit companies. It is also in charge of supervising the activities of the Chamber of Auditors of the Czech Republic (hereinafter referred to as “the Chamber”) and works independently of the auditor profession. The purpose of the Council is to improve credibility of the auditor profession and accounting entities, whose final accounts are verified by auditors, towards both domestic and foreign investors as well as the general public and state institutions. This objective is achieved through improvement of transparency, comfort and, above all, the clients’ confidence in the quality of auditor services. Another purpose of establishing this public oversight body is to increase confidence and security among individuals working in the auditor profession. Another task is to ensure efficient cooperation between the bodies supervising auditor activities in other EU countries (hereinafter referred to as the “EU”) as well as outside of the EU.

# Evaluation of Activities in 2011

## PRESIDIUM

*Section 40 of Act No. 93/2009 Coll., on Auditors*

### **Sessions of the Presidium**

*(1) The Presidium shall be in session as required but at least once in three months. The sessions of the Presidium shall be convened by the President of the Council. If any of the members of the Presidium should request in writing the convocation of an extraordinary session, the President of the Council shall convene such a session no later than within 30 days such a request is delivered.*

In 2011, the Council's Presidium held five sessions, one of which (3 May) took place off site: on 9 March, 3 May, 15 June, 31 August and 2 November 2011.

Ing. Petr Šobotník, President of the Chamber, attended the session of the Presidium held on 9 March 2011, the **tenth** in total, as a guest. He was invited to discuss the issue of recognizing examinations taken outside the Chamber. Petr Šobotník informed about the current structure of the circle of auditors and about the newly introduced cross-sectional examination for admission to the "Auditing II" profession. As a more pressing problem in terms of the need for a prompt amendment to the Act, he considers getting rid of instances when an auditor is self-employed and owns one or more audit companies at the same time. Ing. Rusnok expressed his agreement to not enable creation of unnecessary gaps in qualification testing as audit activities will become more and more important.

The Presidium discussed preparations for the organisation of the Round Table on the topic of the "European Commission's Green Paper – Audit Policy: Lessons from the Crisis" that should take place in April this year. The Department of Financial Accounting and Auditing of the University of Economics, Prague, and the Chamber also participated in the organisation.

The Presidium took cognizance of the letter by Ing. Miroslav Kalousek, Finance Minister, by which he informed the Council about the establishing of the Committee for the Concept and Development of Accounting and Auditing. The Council appointed Ing. Radek Neužil, LL. M. as a member of the Section for Audit and Tax Consultancy of the Committee, and prof. Ing. Libuše Müllerová, CSc., as a member of the Section for the Concepts and Development of Accounting and the Social and Cultural Welfare Fund.

Prof. Ing. Müllerová, CSc., Chairperson of the Committee for Coordination of Education and Professional Examinations, informed the Presidium about the session of the Committee held on 14 February, in particular about the Action Plan for 2011 and two pending appeals regarding exemption from a part of the auditing examination in the subjects of Financial Accounting and Auditing I. The Chamber's decision on not exempting from the examinations was sustained in both cases, and the appeals were dismissed.

The Presidium discussed the questionnaire concerning final accounts that the Council received from the Hungarian oversight body, APOC. The questionnaire was approved and sent to APOC. The Presidium also adopted a proposal in response to the issue of auditor responsibility for the oversight body of Luxembourg with no observations.

Ing. Neužil, LL. M., informed the Presidium about:

- The summary of answers for the EU Green Paper; the final proposals for measures based on the Green Paper would be issued in autumn this year;
- The participation in the European Committee conference "Financial Reporting and Auditing" in Brussels on 9-10 February 2011;
- The meeting of the EGAOB (European Group of Auditors' Oversight Bodies) held on 24 January 2011 where the main topic was the exchange of documents with the USA. The EGAOB is undergoing transformation at present, and only the main body and one preparatory subcommittee remain. The other four subcommittees are being cancelled. The Committee for Quality Inspection becomes independent and will not be funded from the EGAOB anymore, but will operate at the members' own cost.
- Participation at the "Corporate Social Responsibility" conference organised by the Moravian University College Olomouc.

Ing. Liška, Chairman of the Audit Committee, informed the Presidium as to conclusions from the Council management audit that took place late in 2010.

The Chairman of the Committee for Observance of the Quality Inspection System and for Disciplinary Procedures, Ing. Ficbauer, CSc., MBA informed the Presidium about:

- The Report on Activities of the Committee for 2010 he prepared with prof. JUDr. Karfíková, CSc., that was approved by the Committee and distributed to all Presidium members;
- The committee meeting from 25 January 2011, the Action Plan for 2011 and scheduled audits made by the Chamber in the presence of Council's Committee for the Quality Inspection representatives;
- The Council's decision concerning the appeals of three auditors;
- The meeting of the Inspection Subgroup in London in March attended by Ing. Ficbauer, CSc., MBA, together with Ing. Středa, member of the Committee. The subsequent meeting of the Inspection Subgroup was scheduled for June in Berlin. Ing. Ficbauer, CSc.,

MBA, proposed that the Subgroup meeting would also be arranged and organised by the Council in the Czech Republic, and the Presidium agreed with it.

The Council's Secretary informed the Presidium about using the subsidy in 2010 and rendering of their accounts.

The President informed other members about the meeting with the Slovak Audit Oversight Authority representatives that he attended with the Council's Secretary, at which the subsequent meeting for the exchange of information in 2011 was tentatively agreed.

The **eleventh** session of the Presidium held on 3 May 2011 took place in Novosedly near Brno.

Prof. Ing. Libuše Müllerová, CSc., informed the Presidium of the agenda of the two latest meetings of the Committee for Coordination of Education and Professional Examinations. The Committee discussed two appeals concerning an application for exemption from a part of the auditing examination in Financial Accounting, and an appeal concerning exemption from a part of the auditing examination in Auditing I. The appeals were dismissed in both cases and the Chamber's decisions sustained. The Committee finally approved the report on the audit of education before the examination and examinations of the Financial Accounting course conducted by prof. Ing. Bohumil Král, CSc., at the Chamber in December 2010. Furthermore, an appeal concerning the application for exemption from a part of the auditing examination in Information Technologies and Statistics was discussed.

Ing. Radek Neužil, LL. M. informed the Presidium about the prepared amendment to the act on the recognition of qualifications. In addition, the area of registering auditors from third countries was discussed – as there are five auditing entities in the CR that do not meet conditions so that their auditor's reports can be considered auditor's reports under Czech law, the Council asked the Chamber to prepare conditions for registration of these entities. In addition, he informed the Presidium about the EGAOB meeting held on 13 May 2011 in Stockholm where the main topic should be the registration of third country auditors. The Presidium approved the participation of Ing. Petr Šobotník as a representative of the Committee for Coordination and Cooperation on behalf of Ing. Neužil, LL. M.

Ing. Jiří Ficbauer, CSc., MBA, supplied information about the Report of the Chamber's Supervisory Committee (hereinafter referred to as the "Chamber's SC") for the second half of 2010. The submitted report was discussed on 26 April 2011 at the Committee for Observing the Quality Inspection System and for Disciplinary Procedures of the Council with Chamber's

SC representatives, and the report was subsequently submitted to the Council's Presidium for approval.

The Presidium agreed that the report is well prepared in terms of its approach to solving non-quality problems, and gives a good picture of the state of auditing.

The Presidium dealt with the proposal for a modification of Act No. 93/2009 Coll., on auditors, submitted by the Committee for Observing the Quality Inspection System and for Disciplinary Procedures, and with the proposal of Chamber's conditions for the registration of third country auditors. As the date for holding the Round Table on the topic of the Green Paper was postponed, organisational issues were discussed with the possibility of arranging an alternative date at the end of May. At this session, the President of the Council thanked Presidium members, prof. Ing. Müllerová, CSc., and Ing. Zdeněk Liška, for their two-year-long function in the Presidium, as their mandate expired on 15 May 2011.

The **twelfth** session of the Presidium took place again at the seat of the Council on 15 June 2011.

The newly appointed member of the Presidium, prof. Ing. Evžen Kočenda, Ph.D., and the reappointed Ing. Zdeněk Liška took part in this session. At the meeting the "Round Table on the Topic of Audit Regulation: Lessons from the Crisis" seminar was evaluated which had been organised by the Council in cooperation with the Department of Financial Accounting and Auditing of the University of Economics, Prague, and the Chamber late in May. The purpose was to use this event as an informal meeting of experts involved in audit regulation, and as a platform for discussing questions of its aiming in the context of development in the European Union. All participants and lecturers expressed their opinions in particular on the issues of the EC's Green Paper, and agreed, among other things, that this document's timing was not optimal, and despite many inspiring topics which it opened up, the document is not based on practical experience of the application of the relatively newly effective audit directive. Similarly, they were missing a subject analysis of specific impacts of the proposed measures on auditing practice. The Presidium found the Round Table to be a useful opportunity for the meeting of key auditing players in the CR and for sharing opinions on topical issues of audit regulation.

Ing. Rusnok informed prof. Ing. Evžen Kočenda, Ph.D., about the functioning and powers of the Council and activities of each committee, in particular the Committee for Coordination of Education and Professional Examinations, where the function of the Committee's Chairperson still remains unoccupied as the mandate of prof. Ing. Libuše Müllerová, CSc., expired on 15 May 2011. Prof. Ing. Kočenda, Ph.D., was asked whether he would take the function of the Chairman of the Committee, and he agreed to take the chair. Ing. Liška

recommended that prof. Ing. Libuše Müllerová, CSc., should become a member of the Committee due to her experience in chairmanship and experience in auditor education. The Presidium agreed with this proposal adding that this matter falls fully within the competence of prof. Ing. Kočenda, Ph.D. As the mandate of prof. Ing. Müllerová, CSc. expired and she was not present at this session of the Presidium, the Council's Secretary, Bc. Kubrichtová, informed about the latest meeting of the Committee held in April 2011, in particular about an appeal regarding the application for exemption from a part of the auditing examination in Information Technologies and Statistics dealt with the Committee. As the abovementioned appeal lacked the particulars required for issuing a decision by the Council, the applicant was prompted to supplement his appeal within fifteen days, which he failed to do, and as such proceedings were discontinued.

Ing. Radek Neužil, LL. M. informed Ing. Šobotník's business trip abroad who, as a representative of the Council, attended a meeting for European oversight bodies in Stockholm concerning the registration of third country auditors.

In addition, he informed about:

- The last EGAOB meeting where the main topic was, among others, the recapitulation of ways taken by the European countries when concluding bilateral agreements with the PCAOB;
- The European Commission that entrusted the ESCP Europe university to conduct a survey on studying the effects of audit regulation implementation. ESCP Europe addressed with the questionnaire not only regulators but also professional organisations, audit firms, audited companies and other stakeholders. The Council was also contacted.. At its meeting held on 14 June 2011, the Committee for Cooperation prepared a draft response that was, following corrections made by the Presidium, sent on behalf of the Council to the author of the study.
- The amendment to the Act on Auditors. Furthermore, he mentioned other partial modifications of the Act on Auditors forced by related regulations, specifically by the Act on Payment System, Act on Collective Investments, Act on the Recognition of Professional Qualifications and Act on Criminal Liability of Corporate Bodies.

Ing. Neužil, LL. M. informed the Presidium that the Council had been invited to the conference organised by the Federation of European Accountants in Brussels on 30 June 2011.

Ing. Liška, Chairman of the Audit Committee, reported that the audit of Council's management and drawing of funds would take place in July 2011.

Ing. Jiří Ficbauer, CSc., MBA, informed about the action brought and other ongoing audits of the Chamber, for which the Council was overseeing the audit process. Given the demanding

character of the work, Ing. Ficbauer CSc., MBA, asked the Presidium to approve two external people to help out, if required.

The **thirteenth** session of the Presidium took place on 31 August 2011, and in addition to the opening formalities, information was provided as to the termination of the loan contract for non-residential premises of the Council in the building of the Ministry of Finance, Janovského 438/2 in Prague 7 as of 31 December 2011.

Ing. Rusnok recapitulated the Summary Report on the Chamber's Quality Inspection for 2010 submitted to the Council and stated that there is a better image of quality at present than in the past. Furthermore, he stated that the Report contains all substantial facts. Ing. Neužil, LL. M. asked a question regarding the last chapter of the Report, "Generalisation of main deficiencies causing the Supervisory Committee to file a motion for the initiation of disciplinary procedures", and whether the auditors are sufficiently informed about this. Ing. Ficbauer, CSc., MBA responded that the summary reports on quality inspections are open to the public on the Chamber's website and auditors are informed on a regular basis by means of the Auditor journal. Bc. Kubrichtová, Council's Secretary, informed that the Secretariat of the Council continually checks whether the scheduled inspections of auditors are performed on behalf of the Chamber as scheduled.

The Council was asked through the Ministry of Finance for assistance in the analysis and assessment of the accounting and auditing environment status in the CR provided by the MF for the Centre for Financial Reporting Reform (CFRR) of the World Bank.

Ing. Neužil, LL. M. together with Ing. Ficbauer, CSc., MBA and members of the Committee for Cooperation and Coordination in the area of audit and the Czech National Bank ("the CNB") dealt with this issue, filled out the attached questionnaire, and the Presidium approved the answers submitted.

Ing. Neužil, LL. M. asked the Presidium to familiarise itself with the change proposals of the Act on Auditors, and pointed out in particular the section on strengthening the Council's powers in performing audits. Ing. Rusnok is of the opinion that the Council should not take over the Chamber's powers and should retain its existing competencies.

Ing. Liška informed the Presidium about the audit of Council's management carried out on 23 August 2011 in his presence together with members of the Audit Committee, Ing. Barták and Ing. Nutilová. The audit focused on bookkeeping, drawing resources from subsidies and cost records, internal documents of the Council, audit of petty cash documents, audit of

invoices received, bank statements, and payroll documents for the 2<sup>nd</sup> half of 2010 and the year 2011.

The audit did not find any deficiencies and the recommendations from the last record were fully respected. Ing. Liška submitted to the Presidium a draft record of the audit that was subsequently approved.

Ing. Ficbauer, CSc., MBA, summed up the last meeting of the Committee for Observing the Quality Inspection System and for Disciplinary Procedures held on 12 July 2011. He informed in particular about the performed and concluded quality audits under the observance of the Council in 2011 at four audit companies and about ongoing audits. The Council issued two decisions regarding the appeals of three auditors, dismissing all appeals and sustaining the Chamber's decisions. He informed that it was announced at the last EAIG meeting in Berlin that the meeting planned for June 2012 should take place in Prague.

The last session of the Presidium held in 2011 took place on 2 November 2011 and was the **fourteenth** in total.

For the introduction, the semi-annual report on the Chamber SC's activities for the 1<sup>st</sup> half of 2011 was discussed and found to be of a better quality than the previous reports. The Presidium was presented with the statistics from auditing entity inspections conducted in the 1<sup>st</sup> half of 2011 prepared by the Council's Secretariat.

As required by the Committee for Quality Inspection and Disciplinary Procedures, JUDr. Miroslav Kocián prepared a draft internal guideline of the Council regarding procedures of the Council's bodies during the oversight of the auditing quality inspection system, implementation of disciplinary and penalty measures, and the system for the professional and continuous training of statutory auditors of the Chamber.

On behalf of prof. Ing. Kočenda, CSc., Bc. Kubrichtová supplied information about the meeting of the Committee for the Coordination of Training and Professional Examinations of 22 September 2011. This meeting was attended by prof. Ing. Libuše Müllerová, CSc. as a guest, and was asked to become a member of the Committee. The Presidium approved her membership. Bc. Kubrichtová further submitted an audit plan for the 2<sup>nd</sup> half of 2011 and the beginning of 2012 in the subject areas of Microeconomics, Macroeconomics, Management Accounting and Auditing.

Ing. Neužil, LL. M. informed about the meeting of the Committee held on 20 October 2011. With the help of the Committee, the Council reacted to many requirements for sharing

information as part of international cooperation, for example for the publication of disciplinary measures, the retirement age of auditors etc.

All EGAOB meetings planned until the end of 2011 were cancelled, however the oversight bodies agreed on meetings held independently of the EGAOB. The Council's representatives did not attend the meeting scheduled for 28 October 2011 in Madrid. Ing. Neužil, LL. M. informed about the proposal for third country auditor registration that was submitted again to the Council after reworking. The Presidium asked the Chamber about incorporating the objections and recommended it be subsequently published on the Chamber's website.

The Chairman of the Committee for Observing the Quality Inspection System and for Disciplinary Procedures, Ing. Ficbauer, CSc., MBA informed the Presidium about the oversight of quality audits made in the 2<sup>nd</sup> half of 2011 at five auditing entities, one discharged auditor, notice of mandatory audit termination and the request for oversight of an audit company.

## **COMMITTEE FOR OBSERVING THE QUALITY INSPECTION SYSTEM AND FOR DISCIPLINARY PROCEDURES**

In 2011, the Committee constituted the following members:

Chairman: Ing. Jiří Ficbauer, CSc., MBA  
Deputy Chairman: prof. JUDr. Marie Karfíková, CSc.

Members: JUDr. Stanislav Kadečka, Ph.D.  
JUDr. Alena Kohoutková  
Ing. Ivo Středa  
Ing. Pavel Uminský

JUDr. Miroslav Kocián, member of the Committee for Coordination of Education, attended the meetings of the Committee when necessary.

### **1. Action Plan of the Committee for 2011**

The Action Plan of the Committee scheduled the following basic activities for 2011:

- Arrange regular workshops of the Committee;

- Check the organisation, management and operation of the Chamber's auditing activity quality inspection system;
- Check the application of disciplinary and penalty measures used by the Chamber;
- Deal with appeals lodged against decisions taken by the Chamber;
- Deal with issues connected with the notice of termination of contractual relationships concerning the mandatory audit of annual and consolidated final accounts;
- Deal with complaints about the quality of auditors and audit companies work lodged by external entities;
- Deal with suggestions for quality inspection following from reports in the media;
- Take part in EAIG work;
- Comment on proposed adjustments, if any, to the Chamber's internal regulations, specifically to the Disciplinary Code and the Supervisory Code;
- Discuss bi-annual reports of the Chamber's Supervisory Committee on results of quality inspections made by the Chamber for the 2<sup>nd</sup> half of 2010 and the 1<sup>st</sup> half of 2011; and
- Discuss the summary annual report of the Chamber on the quality inspection made by the Chamber in 2010.

## 2. Meetings of the Committee

In total, four regular meetings of the Committee were held in 2011, specifically:

- **25 January 2011. The agenda included the following issues:**
  - Action Plan of the Committee for 2011;
  - Plan of the Chamber's SC inspection activities for the 1<sup>st</sup> quarter of 2011;
  - Annual report of the Committee's activities in 2010;
  - Participation of the Committee's members in Chamber SC's inspections of selected auditing entities;
  - Setting dates of inspections by the SC and the Disciplinary Committee of the Chamber ("Chamber's DC") and participation of Committee members in the inspections;
  - Discussion of the results of the appellate procedure of December 2010 and approval of the *per rollam* voting;
  - Information from the Presidium of the Council;
  - Information from the Presidium of the Chamber and the Executive Committee of the Chamber ("Chamber's EC").
  - Discussion about the auditor – audit company relationship;
  - Council's draft guideline for handling complaints and suggestions.
  
- **26 April 2011. The agenda included the following issues:**

- Report on the travel abroad to London – participation of Ing. Jiří Fiebauer, CSc., MBA, and Ing. Ivo Středa in the EAIG meeting;
  - Notice of termination of the final accounts audit contract between two companies;
  - Bi-annual report of the Chamber’s SC for the 2<sup>nd</sup> half of 2010;
  - Imposing a disciplinary measure on the audit company seated in Prague 1 based on the inspection of auditor’s work quality made by the Chamber in September 2010;
  - Information about quality inspections made so far;
  - Preliminary date of quality inspector training organised by the Chamber on 17 – 18 October 2011;
  - Seminar on the topic of the “Administrative Procedure Code in the Environment of a Professional Organisation” organised by the Chamber on 13 September 2011.
- **12 July 2011. The agenda included the following issues:**
- Information from the EAIG;
  - Conclusion from the oversight of inspection of selected companies;
  - Information about the process of oversight of inspection at selected companies;
  - Action by an auditor brought against the Council through the Municipal Court in Prague;
  - Appellate procedure;
  - Exchange of auditor and audit company certificates for licenses;
  - Plan of quality inspections of the Chamber for the 3<sup>rd</sup> quarter of 2011;
  - Information from the seminar “Round Table on the Topic of Audit Regulation: Lessons from the Crisis” organised by the Council in cooperation with the University of Economics and the Chamber in May 2011;
  - International conference of the Chamber on topical audit issues scheduled for 10 – 11 October 2011 in Prague;
  - Seminar on the topic of the “Administrative Procedure Code in the Environment of a Professional Organisation” organised by the Chamber on 13 September 2011.
- **24 November 2011. The agenda included the following issues:**
- Report of the Chamber’s SC for the 1<sup>st</sup> half of 2011;
  - Plan of quality inspections of the Chamber for the 1<sup>st</sup> quarter of 2012;
  - Application for oversight of the attorney representing the minority shareholder with the audit company;
  - Notice for terminating a contract with an audit company;
  - Information regarding Council guideline No.2 approved by the Presidium regarding the procedure of the Council’s bodies during the oversight of the auditing activity

quality inspection system, application of disciplinary and penalty measures and the professional continuous training of statutory auditors of the Chamber;

- Information from the EAIG;
- Conclusion from the oversight of the quality inspection of selected audit companies;
- Conclusion from the Chamber's SC and DC inspection in August 2011;
- Information about the ongoing inspection of a selected audit company;
- Information about changing the registered address;
- Agreements for carrying out work for the Committee members for 2012.

### **3. Oversight of the organisation, management and operation of the Chamber's auditing activity quality inspection system**

#### **3.1 Oversight of the quality inspection methodology**

This area of the Committee's activities can be divided into the following areas:

- In the area of the quality inspection system organisation, public oversight activities in particular focused on the oversight of:
  - Organisation of quality inspection of auditors and audit companies verifying final accounts and consolidated final accounts of public interest entities; and
  - Organisation of quality inspection of auditors and audit companies verifying final accounts and the consolidated final accounts of other entities.

Within this part of the oversight, the following system aspects were monitored in particular:

- In the area of the plan of inspection activities performed by the Chamber:
  - Preparation and regular updates of the relevant plan of inspection activities in such a manner that these activities are performed at an appropriate quality level at least once every three years in the case of auditors and audit companies verifying the final accounts and consolidated final accounts of public interest entities, and once every six years in other cases;
  - Process implementation of the inspections, i.e. their progress from the decision about the inspection of selected entities up to discussing the conclusion;
  - System for making decisions about exceptional inspections conditioned by the submission of a proposal for conducting the inspection, by information gathered from monitoring mass media etc. including continuity with the previously approved plan of inspection activities;
- In the area of ensuring human resources for inspections:

- The Chamber's method for selecting inspectors to be authorized by the Presidium for the purposes of the quality inspection;
  - Regular training of quality inspectors;
- In the area of ensuring inspections in terms of material and technology:
    - Providing quality inspectors with the appropriate operational, technical and IS/IT background.

In this area, the Committee carried out its regular annual oversight.
  - In the area of management and operation of the quality inspection system, the public oversight activities focused in particular on the following:
    - Assessment of the relevant internal Chamber regulation for the quality inspection of auditors' activities and for carrying out other inspection functions of the Supervisory Committee as set by law;
    - Assessment of inspection methodologies including manuals for inspection issued by the Chamber;
    - Method of inspector nomination for individual inspections, including the submission of proposals for their nomination in justified cases;
    - Practical implementation of quality inspection on the part of auditors and audit companies, in particular:
      - Observance of law;
      - Observance of applicable international auditor standards, and auditor standards issued by the Chamber<sup>1</sup> and the Code of Ethics<sup>2</sup>
      - Fulfilment of requirements for independence<sup>3</sup>, quantity and quality of resources expended;
      - Level of auditors' remuneration;
      - Internal quality management system on the part of the auditor and audit company;
      - Observance of the Chamber's internal rules;
      - Observance of other legislation, e.g. the act on selected measures against legitimization of proceeds of crime and the financing of terrorism<sup>4</sup>;
      - Auditor's insurance, fulfilment of member's duties, e. g. paying membership fees and other liabilities to the Chamber, training, checking of the requirements of the Act that condition issuing auditor licenses;

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1 Section 24 Subsection 5 of the Act.

2 Section 13 of the Act.

3 Section 14 of the Act.

4 Act No. 253/2008 Coll.

- Appropriate method of evaluation of conclusions of quality inspections of auditors and audit companies;
  - Implementation of the inspection of measures taken to improve the quality of work of auditors and audit companies;
  - Administration of relevant documentation of all processes related to the performance of a quality inspection including the appropriate manner of their archiving;
  - Implementation of safe funds for quality inspections that cannot be influenced by auditors;
  - Ensuring independence of inspectors performing quality inspection of a given auditor or audit company;
  - Submission of proposals for changes or reversal of inspection conclusions in exceptional cases.
- The inspection of management and implementation of the quality inspection system was overseen by the Committee in the following manner:
- In the case of quality inspection of auditors and audit companies verifying the final accounts and consolidated final accounts of public interest entities, the inspection took place on a quarterly basis. In the case of these entities, the Council's Presidium can also decide to perform continuous inspections;
  - In the case of quality inspection of auditors and audit companies verifying the final accounts and consolidated final accounts of other entities, the inspections were continuous as decided by the Council;
  - In cases of quality inspection of auditors and audit companies verifying the final accounts and consolidated final accounts of entities, whose activity is supervised by the CNB, the inspections took place at the CNB's request, or quarterly in other cases. In the case of these entities, the Council's Presidium can also decide to perform continuous inspections;
  - In cases of quality inspections of auditors and audit companies verifying final accounts and consolidated final accounts of entities holding a significant economical, organisational or strategically important position with considerable impact on the interests of the general public, which do not have to be public interest entities, the inspection can be carried out continuously based on the Council Presidium's decision.

In cases of complaints about the activities of an auditor or audit company filed to the Council, the Committee has prepared all background documentation related to the submission of the proposal for performing a quality inspection of the auditor. In such cases, the quality inspection of the given auditor or audit company was performed on a continuous basis.

In cases of an appeal against the Council's decision to the administrative court, the Committee prepared all background documentation evidencing the Council's decision for the relevant court.

The annual plan of activities included the setting of specific dates for performing each oversight. Furthermore, the January meeting of the Committee designated the members of individual oversight teams for the first half of 2011; the July meeting designated the members of individual oversight teams for the second half of 2011.

### **3.2 Oversight of quality inspection system organisation by the Chamber in the CR**

In this area, the Committee carried out one oversight during 2011:

▪ 10 August 2011, oversight focused on:

- The area of the plan of inspection activities performed by the Chamber, in particular:
  - Inspections carried out and concluded at selected auditing entities;
  - Preparation and regular updates of the plan of inspection activities;
  - Quality of assessment of inspected auditing entities;
- The area of ensuring human resources for inspections, in particular:
  - Training of quality inspectors;
  - Ensuring sufficient human resources;
- The area of ensuring inspections in terms of material and technical background, in particular:
  - Providing quality inspectors with the appropriate operational, technical and IS/IT background.

#### **3.2.1 Oversight carried out on 10 August 2011**

The oversight was carried out by the oversight team which constituted:  
Ing. Jiří Ficbauer, CSc., MBA, and prof. JUDr. Marie Karfíková, CSc.

The person responsible for the overseen entity was the Chairman of the Chamber's SC and the auditing activity oversight manager.

No major faults were found during the quality inspections at selected audit companies. Increased attention was paid to so far ongoing quality inspections at audit companies initiated by the CNB and the Council. The Chamber will keep the Council regularly informed as to progress made on these inspections.

The Chamber representatives were informed that the Council discussed the report on results of quality inspections made in the 2<sup>nd</sup> half of 2010. The Council

expressed their satisfaction with the level of the quality inspections, consistency and comprehensiveness of the inspections, and respecting the Council's requirements in assessing the level of auditor and audit company quality. In relation to the fulfilment of duties in performing auditing activities and relevant record keeping, the evaluation of auditors and audit companies is clear. Therefore, the Council's requirement has been fulfilled and the Council will continue to monitor whether it is fulfilled. In addition, the Chamber will also evaluate other duties separately. There are duties in the area of training, payment of contributions for Chamber activities, reporting changes for due keeping the list of auditors and audit companies etc. The oversight body members expressed their agreement with this procedure.

The preparation for quality inspector training regarding the rights and obligations from the Administrative Procedure Code to be held on 13 September 2011 was discussed. For the Council, the training was attended by the Council's Secretary and Assistant, and the lecturer is Council Committee member, JUDr. Kadečka. Furthermore, the preparation for quality inspector training regarding inspections of entities whose activities are overseen by the CNB to be held 17–18 October 2011 was discussed. This training was attended by Ing. Ficbauer, CSc., MBA, JUDr. Kohoutková and Ing. Středa.

The inspection activity plan for the 1<sup>st</sup> half and the 3<sup>rd</sup> quarter of 2011 was discussed, and the Chamber representatives were informed about the presence of the Council representatives at other inspections at selected audit companies. The Chamber's SC drafts the plans so that they arrange for quality inspections at three-year or six-year intervals, respectively, taking into consideration conclusions from previous inspections. No faults were found in this area.

By decision of the EC of the Chamber, the oversight of auditors' activities was reinforced by two non-practising auditors. The oversight body members did not deal with proposals for new members. It was recommended to deal with the situation at the EC of the Chamber in a comprehensive manner, including at least a medium-term outlook for the gradual replacement of non-practising auditors, in particular resulting from their retirement.

The material and technical background for quality inspections is currently adequate. Ing. Ficbauer, CSc., MBA informed about intentions of the future IS/IT solution allowing improved and streamlined work of Chamber Authority employees.

All the required tasks were fulfilled by the deadline for this oversight.

For the next period, it will be necessary to focus on the completion of inspection activity methodology in relation to auditors' work quality inspections during management checks and control systems as well as customer asset management reports.

#### **4. Oversight of the application of disciplinary and penalty measures of the Chamber**

##### **4.1 Oversight of the methodology for securing auditors' discipline and imposing sanctions**

In this field, the oversight focused on the following areas of the Chamber's activities:

- The area of organisational arrangements for discipline and sanctions, which namely entails oversight of the following:
  - Corresponding internal regulation of the Chamber in the area of disciplinary punishments and disciplinary procedure set by law, preparation and approval of the relevant internal regulation of the Chamber;
  - Chamber DC's work plan;
  - Observance of process standards during disciplinary procedures and application of disciplinary measures;
  
- Area of practical implementation of disciplinary procedure in cases of auditors and audit companies that have intentionally violated their duties according to Section 25 Subsection 1 of the Act, namely the oversight of:
  - Acceptance of suggestions and procedures during their assessment and subsequent processing;
  - Procedure of the Disciplinary Committee in the event the suggestion is assessed as justified;
  - Procedure before the Disciplinary Committee from its initiation through the check of observance of rights and duties of all involved parties up to the final decision;
  - Proper documentation for the decision, process time limits, methods of their notification and delivery;
  - Proper administration of the disciplinary file;
  - Observance of duties in the area of imposed disciplinary measures (e.g. the publishing of a public admonition, temporary or permanent prohibition of performance of audit activities, payment of fines etc.);
  - Observance of duties in the area of appeal procedure from the receipt of the appeal up to the appeal's body final decision.

The annual plan of activities included the setting of specific dates for performing the oversight. At the same time, the January meeting of the Committee came to a decision about the oversight team members.

## **4.2 Monitoring of enforcing auditors' discipline and imposing sanctions**

The Committee carried out one oversight in this area during 2011:

▪ 10 August 2011, oversight focused on:

- Disciplinary Code and internal regulations relating to disciplinary procedures;
- Chamber DC's work plan;
- Observance of process standards during disciplinary procedures and application of disciplinary measures;
- Fulfilment of tasks implied by the Administrative Procedure Code;
- Amount and enforceability of fines imposed by the Chamber's DC.

### **4.2.1 Oversight carried out on 10 August 2011**

The oversight was carried out by an inspection team constituting Ing. Jiří Ficbauer, CSc., MBA, and prof. JUDr. Marie Karfíková, CSc.

The persons responsible for the inspected entity were the Chairman of the Chamber's DC, Chamber's oversight department employee, and the auditing activity oversight manager.

No faults were found during the oversight of the Disciplinary Code and the internal regulation – methodology manual for issuing Chamber DC's decisions.

The Chamber DC's action plan for 2011 was submitted. The plan reflected all the required Chamber DC's activities in order to cover all activities falling within the DC's competence. In addition on this occasion, issues relating 734 451 123 to the observance of the Administrative Procedure Code, a necessary increase to the Chamber DC's work accuracy including preparation of minutes of meetings and decisions were also discussed. Labour intensity increased as a result No faults were found in this area of activity.

No violations of process standards were found during disciplinary procedures and the application of disciplinary measures. Ing. Ficbauer, CSc., MBA informed the present Chamber's DC representatives that the Presidium of the Council at its last session also dealt with a sufficient level of disciplinary measures imposed, and stated that significant advancement had been made in terms of considering all the required factors, in particular the extent of violation to regulations, which auditors need to follow. The level of disciplinary measures imposed is adequate. However, given the growing number of pending cases, it is necessary to consider the capacity of the Chamber's DC not only for the next period but also in the medium term.

Observance of requirements following from the process standards for disciplinary procedures were checked in selected cases; no faults were found. Furthermore, procedures regarding discussions on individual types of suggestions were verified. Again, no faults were found in this case.

The oversight body members did not find any faults during this oversight and expressed their satisfaction with the level of the DC's work and cooperation of this body with the Council. Based on the oversight, the Chamber recommends considering enhancement of the Chamber DC's capacity so that the increasing number of processed disciplinary procedures can be fluently managed and the DC's members can be replaced in case of their absence.

## **5. Oversight activity performed by the Committee for Quality Inspection at selected audit entities**

During 2011, the Committee performed nine quality inspection oversights of audit entities in total. Out of this number, five quality inspection oversights were performed as part of the regular action plan, and four quality inspection oversights were performed based on reports from the mass media. Based on an external complaint about the quality of an audit company's work, the oversight of quality inspection of the relevant audit company was planned for the first quarter of 2012. Out of this number, eight cases in total concerned audit entities exercising audit activities for public interest entities. This chapter of the report provides information about quality inspection oversights carried out based on the regular work plan. The quality inspection oversights carried out based on information from mass media and based on external complaints are then discussed in separate chapters.

### **5.1 Oversight of the observance of inspection activity methodology at audit entities by the Supervisory Committee**

In all cases of performed inspection activity oversights, the Committee monitored observance of Chamber SC's methodology of inspection activities. In specific terms the oversight focused on the following:

- Method of inspector nomination for individual inspections, including the submission of proposals for their nomination in justified cases;
- Practical implementation of quality inspection on the part of auditors and audit companies, in particular:
  - Observance of law;
  - Observance of applicable international auditor standards, auditor standards issued by the Chamber and the Code of Ethics;

- Fulfilment of requirements for independence, quantity and quality of resources expended;
- Level of auditors' remuneration;
- Internal quality management system on the part of the auditor and audit company;
- Observance of the Chamber's internal rules;
- Observance of other legislation, e.g. the act on selected measures against legitimization of proceeds of crime and the financing of terrorism;
- Auditor's insurance, fulfilment of member's duties, e. g. paying membership fees and other liabilities to the Chamber, training, observance of the requirements of the Act that condition issuing auditor licenses;
- Appropriate method of evaluation of conclusions of quality inspections of auditors and audit companies;
- Implementation of the inspection of measures taken to improve the quality of work of auditors and audit companies;
- Administration of relevant documentation of all processes related to the performance of quality inspection including appropriate manner of their archiving;
- Implementation of safe funds for quality inspections that cannot be influenced by auditors;
- Ensuring independence of inspectors performing quality inspection of given auditor or audit company;
- Submission of proposals for changes or reversal of inspection conclusions in exceptional cases.

No faults were found during the oversight of compliance with the above duties. Nevertheless, it will be necessary to prepare a method of inspection regarding requirements for independence, quantity and quality of resources expended and the level of auditors' fees in more detail. In addition, a more detailed elaboration will be needed for the method of inspection activities concerning:

- Inspections of auditor work quality for audit activities related to checks of bank management and control systems under Section 22 of Act No. 21/1992 Coll. on banks, as amended, Section 8b of Act No. 87/1995 Coll. on savings and credit unions and certain measures related therewith, as amended, and Sections 35-36 of CNB Decree No. 123/2007 Coll. on the rules of prudential operations of banks, savings and credit unions and securities dealers; and
- Inspections of auditor work quality for audit activities related to the Auditor's Report on reasonability of measures taken to protect customer's assets under Section 12e Subsection 3 of Act No. 256/2004 Coll. on business activities on the capital market, as amended.

## **5.2 Results of the oversight of quality inspection performed at the audit company on 21 February – 6 May 2011**

In this case, the entity concerned was an audit company performing audit activities, among others, for public interest entities.

The quality inspection oversight was carried out by the oversight team consisting of:  
Ing. Ivo Středa and Bc. Jana Kubrichtová

The quality inspection oversight was divided into three stages in total; within the first stage, the following was inspected:

- Method of inspector nomination for individual inspections, including the submission of proposals for their nomination in justified cases;
- Auditor's insurance, fulfilment of member's duties, e. g. paying membership fees and other liabilities to the Chamber, education, observance of the requirements of the Act that condition issuing auditor licenses;
- Implementation of safe funds for quality inspections that cannot be influenced by auditors;
- Ensuring independence of inspectors performing quality inspection of given auditor or audit company;
- Submission of proposals for changes or reversal of inspection conclusions in exceptional cases.

The team performed the oversight of compliance with the above duties on 21 February 2011 in the presence of a Chamber officer for the oversight of audit activities. The oversight of compliance with all matters described above did not find any faults. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of inspection.

The second stage of the quality inspection oversight entailed the monitoring of the procedure of Chamber SC's inspection team at a selected audit entity. In particular, this quality inspection oversight focused on:

- A practical implementation of quality inspection on the part of auditors and audit company, in particular:
  - Observance of law;
  - Observance of applicable international auditor standards, auditor standards issued by the Chamber and the Code of Ethics;
  - Fulfilment of requirements for independence, quantity and quality of resources expended;
  - Level of auditors' remuneration;
  - Internal quality management system on the part of the auditor and audit company;

- Observance of the Chamber's internal rules;
- Observance of other legislation, e.g. the act on selected measures against legitimization of proceeds from crime and the financing of terrorism;
- Implementation of the inspection of measures taken to improve the quality of work of auditors and audit company;
- Administration of relevant documentation of all processes relating to the performance of a quality check including the appropriate manner of their archiving.

The oversight team performed the oversight of compliance with the above duties on 16 March 2011 in the presence of Chamber SC representatives and representatives of the inspected audit company. The oversight of compliance with all matters described above did not find any significant faults. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of inspection.

To be specific, the inspection included keeping the auditor's work quality at four clients of the relevant audit company, one of which included a public interest entity. The Committee members were present at the initiation of inspection activities including selection of inspected clients as well as its finalization, which included a discussion of preliminary conclusions from the inspection of selected files of the auditor.

The third stage of the oversight entailed approving the report on the performed quality inspection, which was prepared in cooperation between the Chamber's SC and the inspected audit company. This oversight was performed on 6 May 2011.

The oversight team stated that, although the Chamber's SC inspection team reproached the inspected audit company representatives, when discussing the preliminary conclusions from the inspection of selected auditor's files for an unusually low auditor's fee for the work at the audited company, this fact was not mentioned in the Report on the Result of Inspection Activity.

### **5.3 Results of the oversight of quality inspection performed at the audit company on 12 April – 28 April 2011**

In this case, the entity concerned was an audit company performing audit activities, among others, for public interest entities.

The quality inspection oversight was carried out by the oversight team constituting: prof. JUDr. Marie Karfíková, CSc., Ing. Ivo Středa and Bc. Jana Kubrichtová

Implementation of the quality inspection oversight was divided into three stages as described in Subchapter 5.2 of this Report.

At the first stage, the oversight team performed the oversight on 12 April 2011 in the presence of a Chamber officer for the overseeing of audit activities. The oversight of compliance with all matters described above did not find any faults. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of inspection.

The oversight team carried out the second stage of the oversight on 13 and 14 April 2011 in the presence of two Chamber SC's inspection team members and representatives of the inspected audit company. The oversight of compliance with all matters described above did not find any faults. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of the inspection.

In specific terms, the inspection included keeping the auditor's work quality at four clients of the relevant audit company, one of which was a public interest entity. The oversight team members were present at the start of the inspection when compliance with general requirements defined in the regulations for the activities was inspected, and on the second day of the inspection, when preliminary conclusions from the inspection of selected auditor's files were discussed.

The third stage of the oversight entailed approving the Report on the Result of Inspection Activity signed by the Chamber's inspection team members and inspected audit company members. This oversight was performed on 28 April 2011.

No faults were found during oversight for the legitimacy of the performance of the quality inspection at the audit company.

#### **5.4 Results of the oversight of quality inspection performed at the audit company on 29 April – 23 June 2011**

In this case, the entity concerned was an audit company performing audit activities, among others, for public interest entities.

The quality inspection oversight was carried out by the oversight team constituting:

Ing. Ivo Středa and JUDr. Miroslav Kocián – member of the Committee for Coordination of Education and Professional Examinations

Implementation of the quality inspection oversight was divided into three stages as described in Subchapter 5.2 of this Report.

During the first stage, the oversight team performed the oversight on 29 April 2011 in the presence of a Chamber officer for overseeing audit activities. The oversight of compliance with all matters described above did not find any faults. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of inspection.

The oversight team carried out the second stage of the oversight on 3 May 2011 in the presence of two Chamber SC inspection team members and representatives from the inspected audit company. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of inspection.

In specific terms, the inspection entailed keeping the auditor's work quality at four clients, one of which was a public interest entity. The members of the oversight body overseeing the quality inspection were present during the second day of the inspection, when preliminary conclusions from the inspection of selected auditor's files were discussed.

The third stage of the oversight consisted in approving the Report on the Result of Inspection Activity No. 890/2011 signed by the Chamber's inspection team members and inspected audit company members. This oversight was performed on 23 June 2011.

No faults were found during oversight for the legitimacy of the performance of quality inspection at the audit company.

## **5.5 Results of the oversight of quality inspection performed at the audit company on 6 May – 22 July 2011**

In this case, the entity concerned was an audit company performing audit activities, among others, for public interest entities.

The inspection was carried out by the oversight team consisting of:  
Ing. Jiří Ficbauer, CSc., MBA, and Ing. Pavel Uminský

Implementation of the quality inspection oversight was divided into three stages as described in Subchapter 5.2 of this Report.

At the first stage, the oversight team performed the oversight on 6 May 2011 in the presence of a Chamber officer for the oversight of audit activities. The oversight of compliance with all matters described above did not find any faults. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of the inspection.

The oversight team carried out the second stage of the oversight on 17 May 2011 in the presence of two Chamber SC inspection team members and a representative from the inspected audit company. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of inspection.

In specific terms, the inspection included keeping the auditor's work quality at four clients of the relevant audit company, of which one was a public interest entity. The oversight body members were present during the second day of the inspection, at which preliminary conclusions from the inspection of selected auditor's files were discussed.

The third stage of the oversight entailed approving the Report on the Result of Inspection Activity signed by the Chamber's inspection team members and the inspected audit company. This oversight was performed on 22 July 2011.

No faults were found during oversight for the legitimacy of the performance of quality inspection at the audit company.

## **5.6 Results of the oversight of quality inspection performed at the audit company on 2 September – 27 October 2011**

In this case, the entity concerned was an audit company performing audit activities, among others, for public interest entities.

The inspection was carried out by the oversight team constituting:  
Ing. Jiří Ficbauer, CSc., MBA, JUDr. Alena Kohoutková and Ing. Ivo Středa

Implementation of the quality inspection oversight was divided into three stages as described in Subchapter 5.2 of this Report.

During the first stage, the oversight team performed the oversight on 2 September 2011 in the presence of a Chamber officer for overseeing audit activities. The oversight of compliance with all matters described above did not find any faults. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of the inspection.

The oversight team carried out the second stage of the oversight on 5 and 21 September 2011 in the presence of two Chamber SC inspection team members and representatives from the inspected audit company. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of inspection.

In specific terms, the inspection included keeping the auditor's work quality at fifteen clients of the relevant audit company, four of which were public interest entities. The oversight team members were present on the first and the last day of inspection, and were subsequently present for the preparation of the inspection team (on the premises of the inspected audit company) on the last day of the inspection, at which preliminary conclusions from the inspection of selected auditor's files were discussed.

The third stage of the oversight entailed approving the Report on the Result of Inspection Activity signed by the Chamber's inspection team members and the inspected audit company. This oversight was performed on 27 October 2011.

No faults were found during oversight for the legitimacy of the performance of quality inspection at the audit company.

## **6. Resolution of appeals against Chamber's decisions**

During 2011, the Committee dealt with four appeals in total, one of which was handed repeatedly. The administration time-limit for all of these appeals expired in that year. In addition, the Committee resolved three appeals where the administration time-limit started running in 2010 and expired in 2011.

All three appeals, whose processes started in 2010 and continued in 2011, were concluded in January 2011. The Chamber DC's decision was cancelled in two cases and the matter referred back for reconsideration, and the Chamber DC's decision was upheld in one case. This referred to a public admonition for deficiencies found in the quality of the audit company's work.

Out of the appeals filed in 2011:

- Two cases concerned disciplinary measures imposed in connection with the finding of essential faults in the quality of auditor's activities. A fine was imposed in one case and a temporary prohibition of activities for one year in another case. The Council upheld the Chamber's decisions in both cases.
- In one case, the permanent prohibition of activities was imposed for the auditor's failure to allow the quality inspection. The appeal was first referred to the Chamber due to an incorrect lodging procedure at variance with the Administrative Procedure Code, which caused a lack of competence of the Council to hear the appeal. Consequently, when the obligations defined by the Administrative Procedure Code were fulfilled and a complete disciplinary file was submitted, the Council upheld the Chamber's decision.
- In one case, a fine was imposed due to a failure to fulfil obligations in the area of the auditor's comprehensive professional training. The Council also upheld this Chamber's decision.

The Chamber DC's decisions were upheld in a total of five cases; the Chamber DC's decision was reversed and returned for repeated hearing in two cases in 2011. In accordance with the Administrative Procedure Code, in one case the file was subjected to the Chamber's DC.

## **7. Termination of contractual relationships concerning mandatory audit**

During 2011, the Council received four notifications to terminate mandatory audit contracts. All of these notifications always concerned one specific contract. One notification was made by an accounting entity, three were made by auditors. Out of these four cases, three contracts were terminated by agreement, and one contract was terminated by auditor's notice. Considering the legal titles of the contract terminations, the Committee took cognizance of all the notifications. The Committee recommended the Presidium to take the same position at its session.

## **8. Resolution of complaints regarding the quality auditors' work**

During 2011, the Committee received one complaint regarding the quality of the audit company's work. In accordance with Council Guideline No. 1/2011 "Procedure for handling complaints, suggestions and other applications lodged concerning the Chamber's activities, and for handling appeals against Chamber's decisions in the Audit Public Oversight Council bodies" (hereinafter referred to as the "Guideline"), the Committee proceeded so as to ensure that the interests and obligations of the parties involved were protected by law.

The complaint concerns the investigation of audit procedures related to the audit of conformity of annual reports with the final accounts, and issuance of auditor's reports contrary to law.

In the case of this complaint, the Committee moved for a quality inspection at the audit company concerned. This quality inspection was scheduled for January 2012. The quality inspection was overseen by the oversight team appointed at the meeting of the Committee on 24 November 2011, constituting the following members:

Ing. Jiří Ficbauer, CSc., MBA, and Ing. Pavel Uminský

The inspection of the relevant audit company's work will be carried out in the scope of the filed complaint mentioned above within the meaning of Sections 37 and 38 Subsection 2 letter i) of the Act, provisions of Article 3 Section 2 letter e) of the Council Statutes and of the Guideline.

## **9. Resolution of suggestions concerning auditors' work quality resulting from public information**

As is the case every year, the Committee reacted to reports from the mass media in 2011. These concerned suspected harm done to the clients' property rights in the case of a company, and also financial transactions of a natural person. One audit company was also named in connection to this. . Based on these reports, the Council initiated quality inspections not only at audit companies mentioned by the mass media, but also at other auditors and auditor companies interconnected in terms of personnel, property or otherwise, where any potential links to the cases discussed in the mass media could occur. For this reason quality inspections at a total of four audit companies were initiated based on these reports.

In the case of the company auditor, the quality inspection was overseen by the oversight team consisting of the following members:

prof. JUDr. Marie Karfíková, CSc., Ing. Ivo Středa and Bc. Jana Kubrichtová

The quality inspection oversight was divided into three stages as described in Subchapter 5.2 of this Report.

During the first stage, the oversight team performed the oversight on 25 May 2011 in the presence of a Chamber's officer for the oversight of audit activities. The oversight of compliance with all matters described above did not find any faults. The Chamber's SC

proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of inspection.

The oversight team carried out the second stage of the oversight on 26 May 2011, 27 May 2011 and 1 June 2011 in the presence of four Chamber SC's inspection team members and representatives of the inspected audit company. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of inspection.

In specific terms, the inspection included keeping the auditor's work quality at four clients of the relevant audit company, of which one was a public interest entity. The quality inspection covered three accounting periods in the case of the public interest entity. In the case of other selected clients, the inspection covered three accounting periods at one client, two accounting periods at another client and one accounting period at the last client. The oversight body members were present during the first and the second day of the inspection and at the inspection group preparation on the Chamber premises on the last day of the inspection, where preliminary conclusions from the inspection of selected auditor's files were discussed.

The third stage of the oversight entailed approving the Report on the Result of Inspection Activity of 19 July 2011, or 4 August 2011, respectively, signed by the Chamber's inspection team members and inspected audit company representatives with objections on 27 October 2011. This oversight was performed on 27 October 2011. The oversight included monitoring of the process of handling objections from audit company representatives lodged with the Chamber's SC on 4 August 2011 and decided by the Chamber SC's resolution.

No faults were found during the oversight of the performance of quality inspection at this audit company.

In the case of the audit company named in the mass media, the quality inspection was overseen by the oversight team constituting the following members:

Ing. Zdeněk Liška – member of the Presidium of the Council, Ing. Pavel Uminský and Bc. Jana Kubrichtová

The quality inspection oversight was divided into three stages as described in Subchapter 5.2 of this Report.

During the first stage, the oversight team performed an oversight on 13 June 2011, in the presence of the Chamber SC's Deputy Chairperson. The oversight of compliance with all matters described above did not find any faults. The Chamber's SC proceeded in accordance

with the effective Supervisory Code and methodology of quality inspections at this stage of the inspection.

The oversight team carried out the second stage of the oversight on 14 June 2011, 29 June 2011 and 25 August 2011 in the presence of three Chamber SC inspection team members and representatives from the inspected audit company. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of inspection.

In specific terms the inspection included keeping the auditor's work quality at eight clients of the relevant audit company, one of which was a public interest entity and one a political party. The quality inspection covered one accounting period in all cases. The oversight body members state that no faults were found during the oversight of this stage of inspection, and the Chamber's SC proceeded in accordance with the Act on Auditors, applicable Supervisory Code and the methodology for quality inspections at this stage of inspection.

The third stage of the oversight entailed approving the Report on the Result of Inspection Activity signed by the Chamber's inspection team members on 31 October 2011 and inspected audit company representatives on 23 November 2011. This oversight was performed on 16 December 2011.

No faults were found during the oversight of the performance of quality inspection at this audit company. On the occasion of the quality inspection, the information reported by the mass media concerning the potential flow of money between the audit company and the natural person was also investigated. As the capabilities of inspecting such facts are limited, in particular due to the Act on Auditors and related internal regulations, the Supervisory Committee's inspection team could not verify all particulars. Further procedures were specified later, i.e. in January 2012, at the meeting of the EC of the Chamber that decided to refer the whole matter to the Financial and Analytical Department of the Ministry of Finance of the CR.

In the case of one of the audit companies linked to the company named in the mass media in connection with the natural person, the quality inspection was overseen by the oversight team comprising the following members: prof. JUDr. Marie Karfíková, CSc., JUDr. Alena Kohoutková and Bc. Jana Kubrichtová.

The quality inspection oversight was divided into three stages as described in Subchapter 5.2 of this Report.

During the first stage, the oversight team performed the oversight on 11 October 2011 in the presence of a Chamber officer for the oversight of audit activities. The oversight of compliance with all matters described above did not find any faults. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of the inspection.

The oversight team carried out the second stage of the oversight on 13 – 14 October 2011 in the presence of two Chamber SC's inspection team members and representatives from the inspected audit company. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of inspection.

In specific terms the inspection included keeping the auditor's work quality at three clients of the relevant audit company, two of which were public interest entities. The quality inspection covered one accounting period in all cases. Oversight body members were present during the first and second day of the inspection, at which preliminary conclusions from the inspection of selected auditor's files were discussed. They were also kept informed by the inspection team members about their findings.

The third stage of the oversight entailed approving the Report on the Result of Inspection Activity of 2 November 2011 signed by the Chamber's inspection team members and inspected audit company representatives. This oversight was performed on 29 December 2011. The oversight included monitoring of the process of handling objections of audit company representatives lodged with the Chamber's SC on 9 November 2011 and decided by the Chamber SC's resolution.

No faults were found during the oversight of the performance of quality inspection at this audit company.

In the case of the other audit company linked to the company named in the mass media in connection with the natural person, the quality inspection was overseen by Bc. Jana Kubrichtová.

The quality inspection oversight was divided into three stages as described in Subchapter 5.2 of this Report.

At the first stage, the oversight team performed the oversight on 18 October 2011 in the presence of a Chamber's officer for the oversight of audit activities. The oversight of compliance with all matters described above did not find any faults. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of the inspection.

The oversight team carried out the second stage of the oversight on 24 October 2011 in the presence of two Chamber SC's inspection team members and representatives of the inspected audit company. The Chamber's SC proceeded in accordance with the effective Supervisory Code and methodology of quality inspections at this stage of the inspection.

In specific terms the inspection included keeping the auditor's work quality at two clients of the relevant audit company, neither of which was a public interest entity. The quality inspection covered one accounting period in both cases. The oversight body member was present on the inspection date specified above, and was subsequently kept informed about the results of the inspection.

The third stage of the oversight entailed approving the Report on the Result of Inspection Activity of 2 November 2011 signed by the Chamber's inspection team members and inspected audit company representatives. This oversight was performed on 15 November 2011.

No faults were found during the oversight of the performance of quality inspection at this audit company.

## **10. Actions brought against Audit Public Oversight Council's decisions**

A total of two administrative actions were brought against Council's decisions in 2011, namely:

- with the Municipal Court in Prague, Hybernská 18, 111 21 Prague 1 (hereinafter referred to as the "Municipal Court Hybernská"). The action was brought by an auditor against the Council's decision. On 3 May 2011, the Municipal Court Hybernská called the Council to submit their written opinion on the action and the complete file in the original, including documents of the delivery of the decision to the participants in the proceedings within two months from the delivery of the call. The Council sent all the requested documents and materials to the Court on 28 June 2011. The Court has not yet come to a decision;
- Petition with the Municipal Court in Prague, Slezská 9, 120 00 Prague 2 (hereinafter referred to as the "Municipal Court Slezská"). The action was brought by an auditor against the Council's decision. On 28 November 2011, the Municipal Court Slezská called the Council to submit the complete file in the original, including documents of the delivery of the decision to the participants in the proceedings within two months from the delivery of the call. The Council sent the requested documents and materials to the Court within the required time-limit.

## 11. Work in the European Audit Inspection Group

Six meetings of the EAIG, four of which were duly scheduled and two extraordinary meetings, were held during 2011. The meetings were attended by Ing. Jiří Ficbauer, CSc., MBA. The London meeting was also attended by Ing. Ivo Středa with the consent of the Presidium of the Council. The ordinary meetings took place on the following dates:

- 22 March 2011 in London. The following issues were on the agenda:
  - Discussion on the objective and role of the Group;
  - Discussion of the Minutes from the previous meeting of the EGAOB subgroup;
  - PCAOB's joint inspections;
  - Inspection findings regarding the risk based on the access to the audit and risk assessment.

As such the basic Group's managing document regulating the rules of the Group's activities and management was discussed. The Group is led by a steering group comprising representatives from the United Kingdom, Germany, France, Netherlands and Norway. The basic activities of the Group include:

- Collect inspection findings of the Group members;
- Discuss current causes for inspection findings;
- Identify key problems of audit deficiencies in relation to the standards and audit procedure arising out of them;
- Discuss how quality inspections are performed;
- Discuss specific inspection procedures, reports, requirements for inspections including potential obstacles to performing the inspections;
- Discussions relating to potential examination procedures;
- Give feedback to the EGAOB;
- Share information among professional organisations such as the ECG, IAASB, IESBA, EFAA, EGIAN);
- Share information with audit firms;
- Any other activities in which the EAGOB is interested in.

Furthermore, inspection findings of the oversight bodies were discussed in a generalised form, where problems with the quality of auditors' work primarily comprise the following:

- Formal approaches to the auditor work, when auditors are unable to evidence that they really performed specific procedures of assessing the risks of the engagement;
- Insufficient experience of auditors and also a lower level of knowledge of clients and their specific features;
- Failure to apply an adequate level of caution in the auditors' work (professional scepticism);

- Insufficient instructions to auditors in the group;
- Low level of discussion inside auditor teams in respect of assessing the risks of the engagement;
- Inadequate documentation of some audit procedures.

For the Czech Republic, the following specific audit features were pointed out:

- A low number of large companies operating on the Czech Market, where these companies in particular have sufficient committees, employ the work of internal auditors and other experts and draw up consolidated final accounts;
- Double role of owners who are managers at the same time, which applies in particular to SME companies; It is often more difficult to perform audits in such organisations in terms of some procedures concerning risk assessments of the engagement, defining materiality levels and, of course, audit plans;
- Size of the Czech market with its implications on the distribution of audited organisations and also requirements for a mandatory audit;
- Relatively short history of audit, which is connected to a lack of independent expert knowledgeable about the profession, and a lower level of experience in general.

In addition, information was supplied about the methods of handling or finding frauds and the approach of the Council and the Chamber to handling disciplinary measures.

▪ 7 June 2011 in Berlin. The following issues were on the agenda:

- Approval of the Minutes from the previous EAIG meeting;
- Further discussion on the role and objective of the EAIG;
- Meeting with the IAASB;
- Conclusions from the inspection;
- Joint audits in France;
- Joint inspections with the PCAOB.

The ISA implementation project was presented at the joint meeting with the IAASB. These have been mandatory in the Czech Republic since 2005.

In terms of inspection findings, the meeting discussed the issue of causes of the findings in the area of ISA 315 – Identifying and Assessing of the Risks of Material Misstatement through Understanding the Entity and Its Environment – and ISA 240 – The Auditor’s Responsibilities Relating to Fraud in the Audit of Financial Statements. Causes of weaknesses in auditors’ work were discussed. In addition, information was supplied about the collection of inspection findings of each Group member in the area of implementation of ISA 600 – Audit of Group Financial Statement.

No common conclusion was expressed by the Group in relation to the joint audits carried out in France.

As regards quality inspections carried out in the presence of the PCAOB, basic information was supplied by the representatives of countries experienced in this area of work. These were representatives of the United Kingdom and Switzerland.

- 15 September 2011 in Oslo. The following issues were on the agenda:
  - Conclusions from the inspection;
  - Preparation for the meeting with the IAASB;
  - Meeting with the IAASB;
  - Information about the meeting with the IAASB;
  - PCAOB's joint inspections;
  - The EAIG and the future.

In the part concerning the Inspection Findings, conclusions from inspection findings relating to ISA 315 – Identifying and Assessing of the Risks of Material Misstatement through Understanding the Entity and Its Environment, ISA 330 – The Auditor's Responses to Assessed Risks, and ISA 240 – The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements were discussed and approved.

In addition, the approach to handling non-quality in the UK was presented. The differences from the Czech way of handling non-quality are minimal. The part dealing with the publication of decisions, where each major case is generalised and published along with conclusions concerning non-quality, maintaining confidentiality towards specific entities, was interesting. In principle, these conclusions are divided into decisions relating to:

- Threats relating to the failure of bookkeeping;
- Threats relating to the failure of auditors;
- Threats relating to cases that are not common and are not commonly published.

In this connection the EC representative informed that the EC intends to harmonise specific procedures and they may use these findings. They also intend to harmonise the work of experts (EGAOB, EAIG).

As part of a joint meeting, the IAASB representatives, were firstly introduced to the approach to the auditors' work and the draft ED ISA 610 – Using the Work of Internal Auditors. The generalised knowledge from the findings concerning the ISQC 1 together with proposals for solution were presented by the Dutch representative for the EAIG. The EAIG's opinion on the ED ISA 610 standard was discussed in the second part of the meeting. Disagreement was

expressed with that part of the ED imposing on auditors that internal auditors should become members of sufficient teams, especially due to the violation of auditor independence.

Mutual cooperation in handling proposed ISA amendments was agreed in the last part. Information about joint inspections with the PCAOB was supplied by the representatives of Norway, Netherlands, Switzerland, UK, Hungary and Germany.

Norway has signed an agreement dealing with the practical aspects of mutual cooperation such as confidentiality, access to files and to information in general etc. A joint inspection in one audit organisation was carried out in November 2011.

The second joint inspection already is going on in Switzerland, strictly maintaining the principles of confidentiality and prevention of the abuse of information obtained in the quality inspection. The agreement is concluded for three years and further procedures are to be subsequently decided .

Joint inspections, mainly of subsidiaries by their US parent companies, have been carried out in the United Kingdom for a long time already. It is strange that British representatives are informed about the results with a considerable delay, if at all. This delay can be up to three years. Only a comment form is available in the UK; the final report from the quality inspection is only in the USA.

A contract was signed already in Hungary and they are awaiting the start of these inspections. On the other hand, they are waiting for the conclusion of first joint inspections in Germany. They do not know the results yet. Agreement signing is expected in the Netherlands.

- 6 December 2011 in Paris. The following issues were on the agenda:
  - Conclusions from the inspection (opening by France);
  - PCAOB's joint inspections;
  - Preparation for the meeting with the ECG and EGIAN;
  - Meeting with the ECG and EGIAN;
  - Information about the meeting with the ECG and EGIAN;
  - The EAIG and the future.

In the part concerning Inspection Findings, the French representatives said that further research would focus on the observance of the classified ISAs. It was stated that the findings are not fatal but a varying approach was found in different countries, particularly where the ISAs have not been adopted as a basic framework for the auditors' work.

Furthermore, additional information was supplied from joint inspections with the PCAOB, especially on the part of the United Kingdom, Switzerland and Hungary. A query from the Czech part focused on the finding of some basic facts, in particular who leads the joint inspections, who is responsible for their proper, fair-value performance, and who is responsible for the final discussion of the report from such an inspection with auditors. The knowledge of these facts will be fairly essential in the process of the discussed modifications of the Act on Auditors.

All previous findings of the oversight bodies were discussed in a generalised form in the part concerning the joint meeting with the ECG and EGIAN. Representatives of professional organisations promised to remedy the matter at individual national levels.

**The extraordinary meetings took place:**

- 13 May 2011 in Stockholm. This meeting was attended by Ing. Petr Šobotník, a member for the Committee for Cooperation and Coordination in the area of audit. The following issues were on the agenda:
  - Discussion of the Group's relationship with the EC bodies;
  - Issue of registration of third country auditors;
  - Experience with quality inspections of third country auditors;
  - Up-to-date information about agreements with the PCAOB;
  - Sharing information with third country representatives.

As regards the discussion on the relationship with the EC bodies, the predominating opinion was to continue using mutual consultations in the area of public oversight and propose recommendations for the improvement of work standards for auditors.

A highly differentiated approach is applied by EU member states in the area of registration of third country auditors. The protection of confidential data is of key importance here. It was agreed for German representatives to prepare possible scenarios of further development in this area for discussion.

The protection of confidential data is considered a key issue in the areas of cooperation with the PCAOB and information sharing. Following clarification of this problem, a material used as a joint basis for agreements of each member country with this oversight body could be available.

- 28 October in Madrid. No representative of the Council attended this meeting.

The agenda included the issue of registration of third country auditors including the implementation of the EU Commission decisions in the area of the provision of cross-border

auditor services. For this meeting, we provided answers to questions used to investigate the varying approaches of individual EU member states.

It is possible to state in conclusion of this part of the report that the Council took an active part in the work of this body with a view to monitoring all potential proposals for modification of standards regulating the work of auditors to develop the work of Czech auditors towards its improvement.

## **12. Discussion on reports of the Chamber's SC on the results of their activities in the 2<sup>nd</sup> half of 2010 and the 1<sup>st</sup> half of 2011**

The report for the 2<sup>nd</sup> half of 2010 was sent by the Deputy Chairman of the Chamber's SC, and the report for the 1<sup>st</sup> half of 2011 by the Chairman of the Chamber's SC.

The Committee discussed the presented report for the 2<sup>nd</sup> half of 2010 at its meeting on 26 April 2011. The meeting took place in the presence of the Chamber's SC and DC representatives. The Committee states that the percentage of non-quality of auditors' work is still very high. The representatives of both Chamber's committees clarified that the ambiguous evaluation was performed only in older cases, and the comment of the Council has been newly taken into account, so the evaluation of auditors and audit companies relating to the fulfilment of obligations in performing the auditing activities and keeping the relevant files is now unambiguous. Therefore, the Council's requirement has been fulfilled and the Council will continue to monitor whether it is being fulfilled. Apart from that, the Council was informed that the other obligation would be evaluated as well from now. There are duties in the area of training, payment of contributions for Chamber activities, reporting changes for due keeping the list of auditors and audit companies etc.

Following the discussion the Council stated that the presented report was more detailed than the previous reports and provided a corresponding picture of the quality of the work of auditors, causes of faults and also solutions to those faults.

The Committee discussed the report for the 1<sup>st</sup> half of 2011 first *per rollam*, and then at their meeting on 24 November 2011. The Committee recommended the Presidium to acknowledge the report, and that a letter would be sent requiring an explanation why the Supervisory Committee failed to file a motion for disciplinary procedures in two cases of repeated ratings in the C zone. Following discussions, the letter of the President of the Council to the President of the Chamber required evidencing of this fact. The Chamber reacted to this requirement by their letter from 16 December 2011.

In both cases the Committee also dealt with a sufficient level of disciplinary measures imposed, and stated that there is a considerable shift in relation to considering all relevant factors, in particular the level of violation of regulations that the auditors have to follow. The level of disciplinary measures imposed is adequate. However, given the growing number of pending cases, it is necessary to consider the capacity of the Chamber's DC not only for the next period but also in the medium term.

### **13. Discussion on the Chamber's summary annual report on quality inspection for 2010**

The Committee discussed the summary report on quality inspection for 2010 at its meeting on 12 July 2011. The report contains not only a summary description of all Chamber's activities in the area of auditors' work quality but also a generalisation of causes of faults in terms of auditors' work quality, and also the statement of the market share kept by lower quality auditors. The report is detailed to an adequate level and therefore sufficient.

### **14. Summary results of quality inspections and disciplinary measures since the beginning of Committee's activities**

#### **14.1 Summary information**

The structure of the auditor community is as follows from 22 February 2012:

<b>Auditors</b>	<b>Number of People</b>
<b>Total auditors</b>	<b>1350</b>
<b>a) Total number of active auditors</b>	<b>1297</b>
Of which are self-employed auditors	598
- employed auditors	699
<b>b) Suspended activities (temporary prohibition of activities)</b>	<b>53</b>
Of which are at their own request	46
- by decision of the Council/EC/DC	7
<b>Assistants to auditors</b>	<b>Number of People</b>
<b>Total assistants</b>	<b>785</b>
Of which are employed by the audit company	752
- employed by the self-employed auditor	33

<b>Audit Companies</b>	<b>Number of People</b>
<b>Total number of audit companies</b>	<b>362</b>
<b>a) Total number of active audit companies</b>	<b>359</b>
<b>b) Suspended activities (temporary prohibition of activities)</b>	<b>3</b>
Of which are at their own request	2
- by decision of the Council/EC	1

As such quality inspections have to be performed at 960 auditors or audit companies. Out of that number 109 performs audit services for public interest entities. For this reason quality inspections have to be carried out at about 109 audit companies or auditors, respectively, within three years. A six-year time-limit applies to the other cases. 178 quality inspections have to be performed annually in the Czech Republic. But this number is not sufficient as faults resulting in speeding up the inspection period to two to three years are found in many cases. There are about 60 such quality inspections annually. To keep and gradually improve the quality of Czech auditors' work, up to 238 quality inspections need to be performed annually.

In the Czech environment, a total of 19 experts perform inspection activities, of which 8 are trained quality inspectors and 11 are auditors. These activities are overseen by six experts – Council members. An overwhelming majority of inspections are carried out by teams comprising both trained quality inspectors and auditors, and the burden of the inspection activity rests with quality inspectors. These inspectors carry out inspection activities full time, auditors to a considerably lower extent. The crucial amount of inspection work is then performed by trained inspectors, who are experts outside the auditor practice. Selected Council members also take part in these inspections. Their participation focuses on inspections checking the quality of work of auditors and audit companies which perform audit activities at public interest entities.

Up to 26 quality inspections are allocated to one team annually, which amounts to one inspection roughly every ten days.

#### **14.2 Overall results in the area of auditors' work quality inspections**

Since the beginning of their existence, the Council has put huge pressure on a substantial increase in the number of quality inspections carried out by the Chamber. Since the beginning of Council's existence, i.e. since April 2009, a total of 602 inspections of auditor and audit company's work quality have been completed, of which 148 were completed in 2009, 191 in 2010 and 263 in 2011. Out of this total number, 78 motions for

the initiation of disciplinary procedures were filed. The following table reveals the basic quality inspection results:

Period	No. of Closed Inspections	Repeated Inspection Needed Previously	Share in Total Inspection	Motions for Disciplinary Procedure	Share in Total Inspections	Closed Disciplinary Procedures	Pending Disciplinary Procedures
1 <sup>st</sup> half of 2009	54	36	66.67 %	7	12.96 %	7	0
2 <sup>nd</sup> half of 2009	94	71	75.53 %	5	5.32 %	5	0
<b>Total Year 2009</b>	<b>148</b>	<b>107</b>	<b>72.30 %</b>	<b>12</b>	<b>8.11 %</b>	<b>12</b>	<b>0</b>
1 <sup>st</sup> half of 2010	99	67	67.68 %	14	14.14 %	14	0
2 <sup>nd</sup> half of 2010	92	69	75.00 %	14	15.22 %	14	0
<b>Total Year 2010</b>	<b>191</b>	<b>136</b>	<b>71.20 %</b>	<b>28</b>	<b>14.66 %</b>	<b>28</b>	<b>0</b>

Period	No. of Closed Inspections	Repeated Inspection Needed Previously	Share in Total Inspections	Motions for Disciplinary Procedure	Share in Total Inspections	Closed Disciplinary Procedures	Pending Disciplinary Procedures
1 <sup>st</sup> half of 2011	147	130	88.44 %	15	10.20 %	15	0
2 <sup>nd</sup> half of 2011	116	60	51.72 %	23	19.83 %	21	2
<b>Total Year 2011</b>	<b>263</b>	<b>190</b>	<b>72.24 %</b>	<b>38</b>	<b>14.45 %</b>	<b>36</b>	<b>2</b>
<b>Total</b>	<b>602</b>	<b>433</b>	<b>71.93 %</b>	<b>78</b>	<b>12.96 %</b>	<b>76</b>	<b>2</b>

To provide better information it is necessary to state that about 70 quality inspections per year were made in the Czech Republic before the Council started their activities. So the increase in the number of quality inspections is steep. As the burden of the quality inspections was moved to trained quality inspectors at the beginning of the Council's existence, the difficulty of inspections has grown considerably. This is connected to the relatively big number of auditors and audit companies where quality inspection

must be repeated before the mandatory time-limit of six, or three years, respectively (this shorter time-limit applies to auditors performing audit activities at public interest entities). Furthermore, it is to say that auditors found to do lower quality work cover about 12.5% of the total amount of audit services provided. In most cases these auditors do not provide audit services to public interest entities. Therefore, almost ninety percent of the market is covered by auditors providing audit services of adequate quality.

From the aforementioned overview, it also follows that inspections were made at more than 62% of audit entities. This bears evidence of the capability to handle quality inspections within specified mandatory time-limits, i.e. within a six-year, or three-year time-limit, respectively, in the case of auditors carrying out audit activities at public interest entities. The obligation to carry out quality inspections at auditors carrying out audit activities at public interest entities within a three-year time-limit has been fulfilled. Repeated inspections will start to be performed in 2012.

### **14.3 Imposing disciplinary and penalty measures on auditors**

Disciplinary measures were conducted not only due to insufficient quality of work but also for other reasons. The most frequent other reasons of the disciplinary measures include failure to fulfil obligations in the area of continuous professional training. The table below does not include the results of these disciplinary procedures<sup>5</sup>. The number of closed disciplinary procedures does not follow the above-specified number of filed motions for these procedures due to the time lag in closing previously initiated disciplinary procedures. The overall results of disciplinary procedures conducted due to insufficient quality are shown in the following overview:

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<sup>5</sup> Year 2009 is shown as a total, i.e. not only from the beginning of Council's activities.

Period	Total Closed Disciplinary Procedures	Of which: Admonitions	Of which: Public Admonition	Of which: Fines Imposed in CZK	Of which: Temporary Prohibition of Activities	Of which: Permanent Prohibition of Activities	Average Amount of Fine
2009	30	11	0	394 000.00	0	0	20 737
2010	20	1	0	600 000.00	3	1	40 000
2011	41	4	9	1 802 000.00	5	1	81 909
<b>Total</b>	<b>91</b>	<b>16</b>	<b>9</b>	<b>2 796 000.00</b>	<b>8</b>	<b>2</b>	<b>49 929</b>

Note: All disciplinary procedures are shown for the year 2009, also those that occurred prior to setting up the Council.

In total fourteen appeals were lodged with the Council against the Chamber's decisions. The decisions were eventually upheld in all cases. One of the auditors lodged two complaints about the Council's decisions with the administrative court for the periods mentioned above.

#### 14.4 Most frequently found faults in auditors' work quality

The most frequently found faults include:

Fault	Relevant ISA	Share in Total Number of Inspections
Agreeing the terms of audit engagements	210	58.00
Quality management under ISQC 1, Quality control for an audit of financial statements under ISA 220	ISQC1, 220	73.30
Insufficient audit documentation	230	60.70
Fraud risk assessment	240	75.30
	580	48.00
Consideration of laws and regulations in an audit	250	43.30
Planning audit strategy and audit plan	300	39.30
Understanding the accounting entity's activities and internal audit environment and assessing the risks of the engagement	315	46.70

<b>Fault</b>	<b>Relevant ISA</b>	<b>Share in Total Number of Inspections</b>
Materiality in planning and performing an audit	320	38.70
Responses to assessed risks	330	41.30
Drawing up financial statements and annual report audits	500	30.70
Audit evidence (covering all statements)	501	58.00
External confirmations	505	42.70
Audit sampling and performance of audit procedures	530	52.70
Events subsequent to financial statement date	560	32.70
Going concern	570	32.00
Forming an opinion and auditor's reports on financial statements	700	39.30
Forming an opinion and auditor's reports on annual reports	720	30.70

In general, these faults can be described as follows:

- Poorly formulated audit contracts that do not define documents subject to the audit, or refer to no more valid legal regulations;
- In the area of audit plan drafting, procedures relating to the understanding of the client, client's accounting and internal audit system are poorly documented. The scope of faults does not allow for responsible evaluation of the level of risk assessment relating to the audit work on the project, and thus correct audit procedure planning;
- Fraud risk assessment or adequate communication with client management, statutory bodies and persons responsible for management in this area are often not documented. This results in defective evaluation of potential risks and thereby correct planning of audit procedures in this area;
- Planned and performed procedures insufficiently cover statements about transactions and account balances, in particular completeness and posting in the correct period. Small audit companies and self-employed auditors often omit to distinguish between specific market features of individual clients and employ stereotyped procedures;
- The documentation of procedures performed is not always sufficient. In particular, it is not clear what has been done and what the result was;
- The same holds true in the area of objective correctness tests, which are either incomplete, or fail to give a sufficient description of the reason for their drafting, what area of transaction has been tested and what the result was;

- Sometimes it also happens that inaccuracies found on a sample of transactions or balances are not evaluated in terms of their potential effect on accounting balances, and thereby the client's financial standing and performance. Clear auditor conclusions are often missing in this area;
- The process of drafting a financial statement from the audited ledger is often not documented. This particularly refers to missing evidence for inspecting the link to information shown in the records and the appendix for the audited ledger ;
- It was found in some cases that the auditor failed to mention the accounting entity's statement about assurance regarding the internal audit system and other facts relating to frauds;
- The process of verifying the information shown in the annual report and the report on influence relations is sometimes documented insufficiently.

## **COMMITTEE FOR COORDINATION OF TRAINING AND PROFESSIONAL EXAMINATIONS**

In 2011, the Committee constituted the following members:

Chairperson: prof. Ing. Libuše Müllerová, CSc. (until 15 May 2011)  
 prof. Ing. Evžen Kočenda, Ph.D. (from 15 May 2011)

Members: JUDr. Miroslav Kocián  
 prof. Ing. Bohumil Král, CSc.  
 prof. Ing. Libuše Müllerová, CSc. (after 15 May 2011)  
 Ing. Jiří Pelák, Ph.D.  
 Ing. Jana Skálová

In 2011, the main Committee activities entailed the following:

1. Appeals against the Chamber's decision regarding the non-recognition of an intermediate part of the auditors examination
2. Supervision of the content and progress of preparatory courses for the auditing examination
3. Supervision of the progress of intermediate parts of the auditing examination
4. Monitoring of conditions for entering the profession

### Item 1

During the year, the Committee resolved the appeals of four applicants against the Chamber's decisions regarding recognition of an intermediate part of the auditing examination. The first of the applicants appealed against non-recognition of the intermediate part of the auditing examination in Financial Accounting, and the second applicant appealed against non-recognition of the intermediate part of the auditing examination in Auditing I. The third applicant appealed against non-recognition of the intermediate part of the auditing examination in Information Technologies and Statistics, and the fourth applicant appealed against non-recognition of the intermediate part of the auditing examination in Business Legislation.

The Committee examined the materials submitted regarding the contents of university or professional examinations passed and compared them with the requirements for the intermediate part of the auditing examination of the Chamber. As regards the appeal against non-recognition of the examination in Information Technologies and Statistics, the Committee came to the conclusion that the appeal against the Chamber's decision does not contain the required particulars, and asked the applicant to supplement and specify the appeal, which the applicant failed to do, and the appeal was therefore dismissed. In other cases, too, the Committee came to the conclusion that the decisive part of the content of the university examinations passed was not identical to the content of the given part of the auditing examination of the Chamber. For this reason, the Committee upheld the Chamber's decisions.

### Item 2

The content check and progress of preparatory courses for the auditing examination was carried out for three subjects – Taxation (Ing. Skálová), Business Legislation (JUDr. Kocián), and Management Accounting (prof. Ing. Müllerová, CSc.). The Committee assessed the contents of the courses in relation to the requirements for an auditor's professional profile as well the linkage of the course to the given part of the auditing examination. In addition, feedback from course graduates was made available to the Committee. There were no objections to the subjects of Taxation and Legislation, and the feedback from the candidates was positive with some exceptions. As regards Management Accounting, the Committee recommended distributing the course into more days with a shorter time reserved, as two days with ten hours each are very demanding for the concentration and attention of the candidates. Otherwise this course was considered highly professional and the evaluation of the lecturers was positive.

### Item 3

As part of the oversight of the progress of intermediate parts of the auditing examination, the Committee assessed tasks/questions of the intermediate parts of the auditing examination (Taxation, Business Legislation, Management Accounting) that were held

following the preparatory courses mentioned above. The Committee members, who assessed the examinations, evaluated the difficulty of the contents of those examinations and the time reserved for developing them. In all three cases, they came to the conclusion that in terms of contents, the tasks of the examination corresponded to the requirements for intermediate parts of the auditing examination and that the time limit is appropriate for the difficulty of the tasks. Only for the Management Accounting examination the Chamber's Committee recommended considering the extension of the time limit for the exam by half an hour due to the labour intensity required for it. In addition, the relation between the preparatory course for the auditing examination and the contents of the exam was assessed and no faults were found.

#### Item 4

As part of monitoring conditions for entering the profession, the Committee members came to the conclusion in 2010 already that the new act considerably lowered the requirements for entering the profession. This is the consequence of the following two aspects: the relatively widespread recognition of university and professional examinations (particularly for graduates from universities of economics, the ACCA programme, and professional examinations at the Educational Institute of the Association of Accountants) and the cancellation of the final oral part of the examination. The seven-year time-limit for the recognition of examinations is too long for most subjects, which means that – without a requirement for documenting further continuous education – the professional knowledge cannot be up-to-date. Moreover, by the cancellation of the final oral auditing examination, the possibility of verifying this knowledge was abandoned. For the occasion of the Presidium, the Committee prepared a letter for the Ministry of Finance with a warning of this fact and, at the same time, offered their help in preparing an amendment that would remove some gaps verified in the course of time and made entering the profession more difficult. The letter was sent to the MF in January 2011.

### **COMMITTEE FOR COOPERATION AND COORDINATION OF AUDIT**

In 2011, the Committee constituted the following members:

Chairperson:            Ing. Radek Neužil, LL. M.

Members:                JUDr. Jan Bárta, CSc.  
                              Ing. Petr Kříž  
                              Ing. Jiří Nekovář  
                              Ing. Petr Šobotník

Ing. Věra Mazánková for the Czech National Bank and Ing. Martin Šabo for the Ministry of Finance took part in the work of the Committee as guests.

The Committee's activity focused on two main areas of the issue being discussed. The first one was the regulation of the profession as such in the Czech Republic and the debate about a possible form of the amendment to the Act on Auditors. The second area covered international relations connected with the auditor profession. Thanks to the structure of the Committee and the active approach of permanent members and guests, a discussion platform was formed between all stakeholders involved in auditing. Among others, Public Oversight Council, Ministry of Finance, Czech National Bank and the Chamber representatives took part in the discussion, and the outputs from the Committee's activities serve as a basis for decisions and standpoints held by the Council.

In 2011, the Committee had four ordinary meetings in total, namely on 11 April, 14 June, 20 October and 15 December. The main topic of the meeting referred to amending the Act on Auditors prepared by the Ministry of Finance, which was discussed from several perspectives by the Committee. The Committee members familiarised themselves with the drafter's intentions and expressed their views in terms of legislative and technical proposals for modifying and clarifying the Act that reacted in particular to experience from the implementation of the currently applicable text in practice. They also discussed their standpoint on some principal matters concerning more fundamental changes to the regulation. For instance the first group of problems concerned a more exact definition of the profession, a more specific text leading to unambiguous interpretation of the text of the Act, modification of some issues relating to the list, modification concerning responsibility etc. The members of the Committee agreed, among others, on the recommendation to keep the existing state of the examination qualification without the oral part, also with regard to the fact that too frequent changes to the system could increase uncertainty and worsen transparency of the examination process. Some other modifications are forced by related regulations, for example by the Act on Payment System, Act on Collective Investments, Act on the Recognition of Professional Qualifications, or Act on Criminal Liability of Corporate Bodies. The discussion also included the issue of modification to the Council's position in respect of their role in the area of oversight, and a more precise specification of their competences and powers towards the Chamber and auditors.

In the area of potential changes of a more fundamental character, the Committee is leaning towards the continued discussion and clarification of arguments and motifs for such modifications, and the final proposals should come not only from a relevant expert analysis and from the needs and expectations of regulators and recipients of audit services, but also from the profession as such. Among others, the members of the Committee expressed their

views on the potential new setting of a temporary and permanent prohibition of activities and stated that it is within the interests of all parties for the proposed regulation to reflect the practice and consider, for example, differences between the disciplinary measure and the voluntary or forced change of the formal status of the auditor's position.

In the area of defining auditor liability, there was a general consent as to the fact that there is no immediate need to restrict liability by a percentage of turnover or a fixed limit in the Czech Republic, and the wording should be rather formulated so as to clearly express the principle of proportional auditor liability if damage occurs. During the debate about the potential strengthening of the Council's position as an executor of public oversight, where the existence of the recommendation of the European Committee 2008/362/EC concerning external quality assurance should be considered, Committee members expressed that, in particular with regard to the conditions in the Czech Republic, the established system of functional self-management should be honoured as its function is required and its functionality should be maintained also in the future. The Council's role should be perceived in the position of the oversight body and guarantor of the functioning of regulating principles. In this regard, Committee members agreed that in some cases the competence of the Council should be better regulated, and that as a guarantor of quality, the Council should assume final responsibility for the functioning of the oversight of self-regulatory activities of the Chamber and auditors' activities with a clear possibility to enforce their decisions as part of their competence.

A separate area that the Committee dealt with repeatedly in 2011 was the regulation of registering third country auditors and fulfilment of the relevant provisions of the guideline, or the Act on Auditors, respectively. Although the Chamber did not record any interest on the part of these auditors in the registration, the Council requested, among others based on the instigation of the Ministry of Finance for the Chamber to prepare and publish these conditions. The preparation of the final conditions was based, among others, on recommendations prepared by the advisory group of the European Group of Auditor's Oversight Bodies (EGAOB), and it was also necessary to incorporate the relevant decisions of the European Commission about the equivalence of public oversight systems, quality assurance, investigations and sanctions of some third countries that apply to auditors and audit entities, and about the transitional period for the auditing activities of auditors and audit entities from some third countries of the EU. Owing to the active approach of all stakeholders, the conditions were finally approved and today form part of the website of the Chamber and the Council.

The Committee also dealt with the relationship of the Green Paper on audit regulation published in 2010, an opinion on which was also prepared by the Council on the proposal of the Committee. During the year, the European Commission published documents containing

both reactions to this Green Paper, and eventually also specific proposals for measures to change audit regulation. Representatives of individual institutions within the Committee stated in this connection that they persist in their positions already formulated to the Green Paper and are sceptical of the published proposals for amending the Guideline and the new regulation for the area of audit of public interest entities. The Committee reaffirmed their previous conclusion about the need to maintain professional self-management and although the submitted proposals have many reasonable arguments and also contain the necessary changes, Committee members generally fear that it is unrealistic to achieve the expected objectives of modifications through the proposed tools based on a higher level of regulation, restriction of professional self-management powers and transfer of many competences to the European level. The Committee and subsequently the Council eventually did not approve the official position on these proposals. In most cases however, committee members were able to reach a consensus.

The Committee took an active part in several research and comparative projects concerning audit functioning in the European Union. Among others, this included a survey for a study on the effects of audit regulation implementation conducted by the ESCP as well as a survey for the Centre for Financial Reporting Reform (CFRR) of the World Bank.

The Committee also continuously dealt with some partial initiatives leading to improved transparency of the auditing profession. In cooperation with the Chamber, updating the list of auditors and audit companies improved in this connection, the list was completed and auditors were warned about the obligation to update their data in accordance with the statutory duty.

Members of the Committee also participated in a Round Table meeting on the Green Paper held on 31 May, where the basic attitudes to this document were repeated and open communication among the stakeholders as well as an almost unified opinion in the CR was appreciated.

## **THE CONTROLLING COMMITTEE**

In 2011, the Committee constituted the following members:

Chairperson:           Ing. Zdeněk Liška

Members:               Ing. Ludmila Nutilová  
                              Ing. Tomáš Barták

During the year the Controlling Committee continuously monitored and checked the economic management of the Council.

In August the Committee carried out a check of the books and utilization of expenses in the presence of all Committee members, the Council's Secretary and an external accounting manager; the check was performed in accordance with Section 39 Subsection 13 of Act No. 93/2009 Coll., on Auditors. For verification of the matters mentioned above, a check of the Council's internal documents was carried out as well as a document check of cash, invoices received and the bank account. The Controlling Committee's work was based on Act No. 93/2009 Coll., on Auditors, Act No. 563/1991 Coll., on Accounting, Status of the Council from 1 June 2009, Report on the Council's Activities in 2010 and presented accounting records and documents. There was an inspection as to whether the recommendations given in the minutes from the inspection made in 2010 were fulfilled and it was stated that all recommendations had been fully respected.

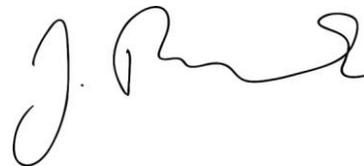
In January 2011 Všeobecná zdravotní pojišťovna health insurance company staff checked public health insurance payments and the observance of other insurance premium payers' obligations, and it was stated that the Council meets their legal obligations fully and in time, plus shows zero liabilities.

In August the Prague Social Security Administration inspected insurance premiums and the observance of health security and pension insurance duties. The conclusions reveal that the Council fulfilled all mandatory obligations in the period under review, and the recapitulation of any found arrears or overpayments of social security insurance, contributions to state policy of employment and overpayments of sickness insurance allowances amount to zero over the entire period under review.

The formal and the material inspection by the Controlling Committee led to the conclusion that the Council fully meets its legal obligations in this area in terms of timeliness and material content. Although the Council drafts only a record (as an organisation established "by law"), their accounting is kept as that of a non-profit organisation. This gives a sufficient overview of evidence of the Council's activities.

This Report on Activities was prepared and issued in accordance with Act No. 93/2009 Coll., on Auditors, Section 38 Subsection 3 as a report on the public oversight of audit in the Czech Republic in 2011.

Prague, June 2012

A handwritten signature in black ink, consisting of a large, stylized 'J' followed by a series of connected loops and a final flourish.

Ing. Jiří Rusnok  
President