

# CPA'S DUTIES TOWARD FRAUD DETECTION AND REPORTING: TAIWAN REGULATIONS

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## ABSTRACT

*This paper aims to review CPAs' responsibilities for fraud detection and reporting. It will first explore, through literature analysis and review of Taiwan regulation, the accounting professions' changing stand toward CPAs' responsibilities to detect and report fraud. In addition, Taiwan's existing laws and profession promulgations on CPAs' fraud-related responsibilities will be examined and discussed. Finally, the 2002 US Sarbanes-Oxley Act's impact on Taiwan CPAs' duties in fraud detection and Taiwan government's responses to such duties by expectations gap will be examined.*

**JEL:** M42; M48

**KEYWORDS:** Auditor's responsibility, fraud detection, auditing regulations, audit profession,

## INTRODUCTION

In Taiwan, the series of corporate failures since 2000, notably Chung Shing Bank and Procomp Informatics, is reminiscent of Enron and WorldCom in notoriety. Their collapse due to management's fraudulent or misrepresented financial statements typically occurs within such short period that shareholders have insufficient time to respond, resulting in huge investment losses.

The question naturally arises: Who is to blame? Responsibilities placed by the Taiwan investing public on CPAs over the veracity and accuracy of financial statements have often been far above what the accountant himself deems he can handle. The claim traditionally made by Taiwan accountants is: "Fraud is very difficult to detect." Some insist this ought to be understandable (Cheng, 2004, Liao, 2006). Taiwan corporate businessmen are especially cunning and expert at camouflaging material they do not want you to see, making it virtually impossible for you to implicate them due to lack of direct evidence. But the public asks, "If you are unable to detect fraud, then what do we need you for?" Accountants rebut by contending that business collapse due to company fraud is corporate responsibility, not accountants', because undetected fraud does not equate to audit failure, and accountants only have to answer to audit failure. But from the point of view of financial statement users, their expectations cannot be met, hence the gap persists (Liao, 2006; Ma, 2006a). And this seemingly impossible to eliminate expectation gap fluctuates with ever-changing external conditions- each time a big case involving fraudulent financial reporting erupts, the gap widens. If this gap continues to broaden to the point when public trust buckles, that would signify the start of the breakdown of capital market.

In relation to the audit expectations gap, the CPA's responsibility to detect fraud is probably at its widest when company failures are publicized amid insinuations of fraud and malpractice. This paper focuses upon CPAs' responsibilities for fraud detection and reporting. It will first explore, through historical analysis and review, the accounting professions' changing stand toward CPAs' responsibilities to detect and report fraud. In addition, Taiwan's existing laws and profession promulgations on CPAs' fraud-related responsibilities will be examined and discussed. Finally, the US 2002 Sarbanes-Oxley (hereafter SOX) Act's impact on Taiwan CPAs' duties in fraud detection and Taiwan government's responses to such duties are examined.

## LITERATURE REVIEW

An early study made by Lee (1970) suggested that up to the beginning of the 20<sup>th</sup> century, “undoubtedly fraud detection moved toward the giving of an opinion on the credibility of accounting information. The importance of fraud detection as an audit objective was indeed downplayed, as later auditing literature took the modern approach to an audit, emphasizing more the principle of testing, the desirability of instituting systems of financial and accounting controls within the company, and the overall fairness of the financial statements (Flint 1971; Lee 1970; Humphrey *et al* 1993; Porter 1997).

The banking crisis and corporate frauds during the mid-1970s initiated investigations into CPA’s responsibilities in detection and reporting fraud. The Cohen Commission, established in 1974, concluded that an audit should be designed to provide reasonable assurance that the financial statements are not affected by material fraud. This fell rather short of a requirement that CPA should be responsible for fraud (CAR, 1978).

Numerous surveys conducted during the 1970s and 1980s verified the existence of audit expectations gap, that is, the difference in perceptions between the auditors and the users of financial statements. The studies found that auditors were very opposed to added responsibilities for detecting fraud whereas the users held the opposite views (Beck, 1973; Arthur Andersen & Co, 1974; Baron *et al*, 1977; CICA, 1986; Steen, 1990).

Low and Kurt (1993) surveyed jurors’ and auditors’ perceptions regarding auditor responsibility to detect fraud. The study found huge divergence of beliefs and expectations between auditors and jurors. Jurors in the study regard the auditor’s role as guardian or watchdog, one who should be held responsible when a company fails or when fraud is uncovered after the issuance of a clean opinion. Auditors, on the other hand, perceived that fraud detection is not their major responsibility during an audit.

Detecting and reporting fraud is a significant element in the rendering of audit services and litigation is a possible consequence for auditors who fail to fulfill their responsibilities in this regard. Bonner *et al* (1998) examine the type of fraud matters in the occurrence of litigation against auditors by comparing three groups of companies with SEC enforcement actions—those with auditor litigation, those with financial reporting and disclosure litigation not involving auditors (other litigation), and those with no reporting and disclosure litigation. The study indicated the auditor bears the legal responsibility and is likely to be sued when a company’s financial statements contain a fraud that is commonly occurring or that involves fictitious transactions and events.

Ramos (2003) discussed the auditor’s role in fraud detection by referring the new era in auditors’ requirements adapted from Fraud Detection—SAS No. 99 Implementation Guide. He compared required audit procedures prior to issuing SAS No. 99 with those in SAS No. 99, and concluded that auditors would enter a much expanded arena of procedures to detect fraud as they implement SAS no. 99. The study findings suggested that auditors are held responsible for the detection of fraudulent financial statements, while the responsibility to prevent and detect all fraud (either employee or management fraud) rests with management of the company.

An auditor should be responsible for his audit failure—an incorrect audit report issuance when he fails to comply with the requirement of auditing standards. Huang (2003) explored the civil liabilities under CPA Act and Securities and Exchange Act (SE Act) from aspects of the financial reports’ purposes, the nature and regulation of audit work. He argued that auditors face potential legal liabilities when, without due professional care, they are unable to detect material misstatements in the financial report. The argument is consistent with the generally accepted auditing principles that auditors should be responsible for their negligent performance during an audit. Strengthening the auditor responsibilities does not

mean restraining the accountancy profession's development; quite the contrary, it seeks to advance audit quality.

Enron's collapse initiated creation of the SOX Act in 2002, which greatly expanded the responsibilities of public companies and their auditors. SOX influenced the accountancy profession outside the US as well. Studies have been increasingly focused on auditor's responsibilities expected by the users of financial statements. There is still no consensus about the auditor's role, as far as fraud detection is concerned. In a study in Bangladesh, Chowdhury *et al.* (2005) found that a wide expectation gap existed pertaining to fraud and auditor responsibility. In study in Malaysia, Fadzly and Ahmad (2004) uncovered wide expectation gaps and misconceptions about auditing. They found significant support of the existence of an expectation gap, chiefly on issues relating to auditors' responsibilities. Dixon *et al.* (2006) uncovered the existence of a significant expectation gap in Egypt, especially in auditors' responsibilities for fraud prevention and detection.

In Taiwan, well-publicized corporate frauds by Procomp Informatics in 2004, prompted the investing public to demand that government and the accountancy profession take action in response to the big scandal. It appears that the expectation gap would not be narrowed or eliminated. Financial statements users wanted CPAs to have legal duty to detect fraud, such view given muscle from SOX 2002 (Ma, 2006b). Public criticism of the profession's position mounted, and stirred the accountancy profession into activity. It was previously held that responsibilities to prevent and detect fraud firmly rest on company management, not on the CPA of the company. However, companies continued to collapse, substantial fraud continued to occur, and funds continued to disappear. Parliament members were critical, and government threatened regulatory legislation. Mounting public pressure finally brought about changes in legislation and professional pronouncements in Taiwan. The following section discusses the CPA duties in the Taiwan regulations and professional guidelines.

## **THE CPA'S RESPONSIBILITIES FOR FRAUD AS REGULATED BY LAW AND PROFESSIONAL GUIDELINE: HISTORICAL DEVELOPMENT**

### Law

Taiwan CPAs were governed by the Ministry of Finance and the Taiwan Securities and Future Exchange Committee (TSFEC) before the FSC has established on July 1 2004. FSC has since taken over the charge of Taiwan CPAs. Three acts are particularly important for Taiwan CPAs, namely: (1) the Companies Act; (2) the CPA Act; and (3) the SE Act.

According to paragraph 64 of the Taiwanese Company Act, the audit of financial statements should be performed by one or more external CPAs. The CPA(s) will be appointed by the general meeting of shareholders. It is mandatory that the CPA is a member of one of Taiwan's CPAs Unions. Under SE Act's Article 36, any company issuing securities under the law should announce to the public and register with the Competent Authority financial statements which have been duly audited and certified by a CPA, approved by the board of directors, and recognized by the supervisory committee. This statutory requirement gives CPAs the preferential right to audit the company's financial statements.

Article 174 of SE Act require CPAs be held responsible for failure to faithfully issue a report or opinion with respect to any material falsehood or error in a financial report, or failure to expressly state a material falsehood or error in a company financial report due to failure to audit in accordance with applicable laws and regulations and generally accepted audit principles.

The CPA Act, introduced in 1945, also sets management and litigation rules for CPAs. CPAs cannot have any improper conduct or violate or neglect his professional responsibilities in the performance of an

audit (Article 17). They should perform their service with due professional care. Furthermore, when conducting an audit, CPAs should avoid concealing the financial information which they know to be directly detrimental to the right and interest of interested parties, or making false or improper certification of the financial statements. CPAs are required to issue an audit report on the financial statements which is sufficient to cause injury to the right and interest of his client or interested parties, owing to his undue intent or negligence in the performance of their professional services (Article 24). CPAs who violate any of the requirements ruled in the CPA Act or SE Act or Company Act face one of the following sanctions as a result of the litigation (Article 40 of CPA Act): (1) Warning, (2) Reprimand, (3) Suspension of practice for a period from two months up to two years, and (4) Expulsion.

### Auditing Standards

In 1984, Taiwan's Accounting Research and Development Foundation (ARDF) took over the National Federation of Certified Public Accountants Association, which was responsible for the development of the 'accountancy profession' and had a number of committees dealing with matters such as education, ethics and peer review before 1984.

ARDF has four committees: Financial Accounting Standards Committee (FASC), the Auditing Standards Committee (ASC), the Accounting System Committee, and the Education and Training Committee (ETC). ASC, resembling the Auditing Standards Board of AICPA in the US, establishes generally accepted auditing standards (GAAS) in Taiwan. The standards-setting process includes problems identification, exposure draft preparation, public hearings, exposure draft revision, and the issuance of standards. Generally, the auditing standards in Taiwan follow those of the US. The ASC has issued both Statements of Auditing Standards (SAS) 14 (1987 issuance) and SAS 29 (1996 issuance), which regulate CPA responsibilities for fraud detection, reporting and prevention.

The objectives of the Taiwanese SAS 14 (TASC, 1987) are: (1) to distinguish the responsibility of detection for fraud from errors which cause material misstatements of financial statements when CPAs conduct an audit, and, (2) to provide guidelines to the CPA regarding the responsibility of considering fraud and error in an audit of the financial statements.

The core concept of Taiwanese SAS 14 is that responsibilities to prevent and detect fraud and errors lie upon company management, however, CPAs should plan and perform their audit works with due care so that material misstatements in financial statements arising from fraud or error can be uncovered. Except as additional service to clients, audit programs and procedures are not designed principally to detect fraud or errors (para. 4). This implies that CPAs should not be held responsible for detecting the occurrence of fraud or error. The reason for planning and performing an audit with due care is merely to reasonably ascertain that the financial statements of the company are fairly presented.

Taiwanese SAS 14 defines 'fraud' as intentional misrepresentations of financial statements, and illustrates the errors as unintentional mistaken in financial statements. Table 1 summarizes the illustrations in SAS 14: According to Taiwanese SAS 14, the CPA is not primarily responsible for the prevention of fraud and error. The responsibility rests with management. An audit may however act as a deterrent. Taiwanese SAS 14 states that an appropriate system of internal and accounting controls is management's primary tool to prevent and to detect fraud and error. However, it acknowledges that while such a system reduces the occurrences of fraud and error, it does not eliminate them (para 3).

It is the CPA's responsibility to perform an audit which will provide reasonable assurance that the financial statements are free from material misstatements. The audit programs should be based on generally accepted accounting standards and an assessment of the risk that fraud or error may cause the financial statements to contain material misstatements. Taiwanese SAS 14 provides a checklist of risk

factors to be taken into consideration while compiling the audit program. The suggested risk factors (para 8) are one of the following: (1) questions with respect to the integrity or competence of management, (2) unusual pressures within or on the entity, (3) unusual transactions, and (4) difficulties in obtaining sufficient appropriate audit evidence.

Table 1: Illustrations of Fraud and Errors

Fraud	Errors
(1) falsification or alteration of records or documents	(1) mathematical calculation errors in the underlying records and accounting data
(2) concealment of records or material information on documents	(2) oversight or misinterpretation of facts
(3) suppression or omission of transactions from accounts	(3) misapplication of accounting policies
(4) intentional misapplication of accounting policies	
(5) misappropriation of company assets	

*Table illustrations are given in terms of the definition of fraud and errors in the Taiwanese SAS 14 (TASC, 1987)*

Although Taiwanese SAS 14 states that the responsibility for preventing and detecting fraud rests with management, it is the CPA's responsibility to design audit procedures based on the risk assessment, to obtain reasonable assurance that misstatements arising from fraud or error are detected which are material to the financial statements taken as a whole. Taiwanese SAS 14 includes no statement about reporting to a third party, or about withdrawal from the engagement.

Taiwanese SAS 29 (TASC, 1996), issued in 1996, deals with the CPA's consideration of laws and regulations in an audit of the financial statements. The number and variety of laws and regulations that may be applicable to an entity can be substantial. It is clear that special knowledge of all applicable laws and regulations is beyond the CPA's normal expertise. Therefore, based on Taiwanese SAS 29, the CPA is not and cannot be held responsible for preventing and detecting non-compliance with laws and regulations. This responsibility rests entirely with management (para 5). An annual audit may act as a deterrent (para 8). With regard to the responsibility of the CPA for the detection of non-compliance with laws and regulations, however, the CPA should obtain a general understanding of the company's legal framework and its articles of incorporation. Furthermore, the CPA should adopt an attitude of due professional care and professional skepticism with regard to the risk of non-compliance. This is particularly applicable to laws and regulations that have a direct impact on the company's financial statements (para 7).

Since non-compliance with laws and regulations may have a material contingent effect on the financial position of the company, it is difficult to entirely exempt the CPA's responsibility in this respect. On the other hand, whether an act of non-compliance constitutes non-compliance in a legal sense is a legal determination by a court or Competent Authority, which is normally beyond the CPA's expertise (para 11). Based on his general knowledge of the company, its industry, and the applicable regulations, the CPA may consider whether legal assistance and advice is needed under the circumstances. Having acquired a general understanding, it is the CPA's responsibility to perform procedures that are helpful in identifying instances of non-compliance with laws and regulations (para 13), such as (1) inquiring of management as to whether the entity is in compliance with such laws and regulations, and (2) inspecting correspondence with relevant licensing or regulatory authorities.

Furthermore, the CPA should obtain sufficient audit evidence about the compliance with applicable laws and regulations having an effect on the determination of material amounts and disclosures in the financial statements. The CPA should have sufficient understanding of such laws and regulations. Finally, the CPA should obtain written representations from management that it has disclosed to the CPA all known actual or possible non-compliance with laws and regulations whose effects should be considered when preparing the financial statements. No other procedures are required with regard to compliance with laws and regulations (para 14, 15 and 18).

If the CPA becomes aware of a possible departure from the law or regulations, he should obtain an understanding of the possible effect of such departure on the financial statements (para 21). Such indications need to be reported to and discussed with the senior management of the company, its Board of Directors, or its supervisory committee (para 26). In the case of a material departure from the law or regulations, the Board of Directors or the supervisory committee needs to be notified without delay. In this case, the CPA needs to consider the effect on the financial statements and on the CPA's opinion.

If the Board of Directors fails to take sufficient remedial action to prevent the future occurrence of material non-compliance with laws and regulations and fails to disclose the results of the departure properly into the financial statements, the CPA needs to inform the successor CPA about the reason for withdrawing from the engagement. If the client's management does not give permission for informing the successor CPA, the CPA should inform the proposed CPA accordingly (para 31).

#### Recent Development of Professional Promulgations: Taiwanese SAS 43 (TASC, 2006)

On September 1, 2006, Taiwan's ASC, which as mentioned earlier is under ARDF, issued SAS 43- "The CPA's Responsibility to Consider Fraud in an Audit of Financial Statements", effective for audits of financial statement for periods ending on or after 31 December, 2006. Replacing 1987 SAS 14: "Fraud and Error" which has been around for over 20 years, it is now the corporate fraud standard for CPAs in Taiwan.

*Rationale* : Two types of compromises can severely affect the quality of audit work: impartiality/independence compromises, and professional compromises. Independence compromises will be addressed by legislation to be covered in the next section. Professional compromises do not always have to do with the individual CPA's educational background or experience, but may be due to deficiencies in established audit standards themselves.

Prior to 2006, SAS 14 is one of two audit standards, the only two in Taiwan, relating to corporate fraud. It has been around for over 20 years. No matter how much Taiwan's corporate enterprises have expanded in scope or complexity, or have undergone how many financial crises, the standards have never changed. In contrast, US/UK has amended their corporate fraud audit standards numerous times. If Taiwan also experienced a similar series of corporate fraud cases as U.S. /U.K., and if US/UK finds it necessary to amend their audit standards, it stands to reason that SAS 14 must also be antiquated for Taiwan. Thus ASC, which as mentioned previously is under ARDF, proceeded in 2005 to revise SAS 14, and on September 1, 2006, issued SAS 43- "The CPA's Responsibility to Consider Fraud in an Audit of Financial Statements", effective for audits of financial statement for periods ending on or after 31 December, 2006. Replacing 1987 SAS 14: "Fraud and Error", it is now the corporate fraud standard for CPAs in Taiwan.

SAS 43 attempts to rectify SAS 14's deficiencies in such areas as fraud definition and CPA responsibilities. Paragraph 2 of SAS 14, in defining fraud as "intentional misrepresentation of financial information", used as illustrations "intentional misuse of accounting principles" and "misappropriation of assets". Yet SAS 43 clearly distinguishes fraud from error and describes the two types of fraud (misstatements resulting from fraudulent financial reporting and misstatement from misappropriation of assets) that are relevant to the auditor.

With regards to CPA responsibilities, SAS 14's Item 4 is even more misleading. It states "... the planning and implementation of audit work is not designed to discover "fraud or error" per se, but (CPAs) should still maintain professional vigilance so that during the audit process, material misstatements of financial information due to "fraud or error" may be discovered".

The “fraud or error” mentioned in the first half of this quote pertains only to that stemming from asset misappropriation. It does not include fraudulent financial statements. Conversely, the “fraud or error” mentioned in the latter half of the quote refers exclusively to fraudulent financial statements and excludes fraudulent asset misappropriation. The same phrase “fraud or error” is used in two different contexts. When dispute arises, CPAs, citing Item 4’s front half, claim the audit process is not designed to discover “fraud or error” per se; legal practitioners, on the other hand, cite Item 4’s second half and stress that accountants are supposed to maintain an attitude of professional vigilance.

Each side has its own argument basis. Therefore, to settle disputes once and for all, SAS 43 got rid of Item 4 and rephrased CPA responsibility as: “carry out audit work according to GAAS, to reasonably ascertain that financial statements overall contain no material misstatements due to fraud or error”(Item 21 first half), and, “to obtain reasonable certainty, CPA should maintain professional vigilance throughout the entire audit process and entertain the possibility that management may have exercised control override” (Item 22), thus clarifying that while CPA *attitude* should be one of professional vigilance, his *responsibility* goes only as far as certifying whether financial statements overall contained any material misstatements. Besides making CPA responsibility more precise, SAS 43 differs from SAS 14. Table 2 gives the different respects between SAS 43 and 14.

Table 2: The Different Respects in SAS 43 from SAS 14

	Respects	Contents
1	Emphasis shifted from “fraud or error” to just “fraud	Distinguishes error from fraud; defines what constitutes error, material misstatement, and fraud; separates 2 fraud categories: those arising from fraudulent financial reporting and those involving misappropriation of assets.
2	Inherent limitation of fraud detection.	Points out auditor may commit error while auditing financial statement due to inherent limitation of fraud detection.
3	Recognition and reevaluation of the risk of material misstatements resulting from fraud	Recognition and preliminary assessment of material misstatements risk, including overall as well as individual item misstatement, especially revenue misstatement risk; also ascertain if risk controls designed by auditee are actually implemented.
4	Interpretation of “professional skepticism”	The attitude for professional skepticism should to be maintained even if auditor, from past experience, deems management and supervisors of auditee to be honest and upright; mechanics of how to accomplish this made more precise.
5	Illustrations of risk factors	In the SAS 43 appendix there are 3 illustrations for handy reference by accountants and CPAs - Fraud Risk Factors Illustration, Audit Procedure Illustration for Material Misstatements Resulting from Fraud, Plausible Fraud Situations Illustration.

*This table shows different aspects of Taiwanese SAS 43, clarifying the auditor’s responsibilities for fraud. The author of this paper compares and summarizes in this table features from Taiwanese SAS 14 (TASC, 198) and SAS 43(TASC, 2006).*

### Recent Development of CPA Act Amendment 2007

*Rationale* : Since its promulgation on June 30, 1945, the CPA Act in Taiwan has undergone nine separate revisions. This notwithstanding, following the rapid development of Taiwan’s domestic economy and the concomitant expansion of accountants’ official functions and duties, some of its regulations have become anachronistic over the years. Thereupon, improving CPAs’ professional environment, bringing CPA specialty and expertise into full play, and raising CPA performance quality - all call for a thorough reexamination and rectification of the CPA Act. Moreover, in an effort to raise overall CPA standards in Taiwan, the Finance Division of the Advisory Committee for Economic Development reached a unanimous decision on August 29, 2001 to invite scholars, experts, and representatives from the business sector, under the auspices of the Treasury Department, to form the so-called “Reform Task Force for Business Enterprises’ Robust CPA System”.

One significant reform agenda of this task force is precisely the CPA Act amendment draft. The course, direction, and content of this amendment was arrived at through sectional discussions centering around

the topic of “Strengthening External CPA Independence & Effectiveness”, with input from both the academic and the business world (Huang and Lin, 2006). Assimilating input from scholars and practitioners, revision goals of the CPA Act amendment were broken up into two categories for closer scrutinized. Table 3 summarizes each goal.

Table 3: Two Goals Revision for CPA Act Amendment 2007

Category	Descriptions
Goal A: Establish desirable CPA practice environment	<ol style="list-style-type: none"> <li>(1) Introduce accounting corporation structure in response to the development of Taiwan’s capital market, internationalization of business enterprises, and large-scale trend of CPA firms—endowing them with corporation status helps to ensure their interminable operation, and keeps Taiwan in synchronization with international trends.</li> <li>(2) Expand penalty sentencing regulations to forestall CPAs’ reputation being tainted due to offenses committed by a few. The new penalty provisions, patterned after the Security Exchange Act, encompass broader territory ranging from reprimand citation, monetary fines, business closure, to the most serious business establishment permission.</li> <li>(3) Investigation of accounting firms: This provision allows inspector officials from the Financial Supervisory Commission (FSC) to inspect accounting firms’ business and related financial condition. Accounting firms may not dodge, obstruct, or refuse such inspections.</li> </ol>
Goal B: Elevation of CPA audit qualities	<ol style="list-style-type: none"> <li>(1) This amendment added provision that CPAs performing company consulting work or engaged in other non-audit work which could possibly influence CPA independence, may not accept job offers requiring the certification, approval, and validation of corporate financial reports.</li> <li>(2) CPA pre-job training and ongoing professional training is required to raise quality standards and certification skills.</li> <li>(3) CPA business practice suspended if upgrade requirement not met after being notified of deadline by National CPA Association. CPA license registration revoked if business practice not restored after one year’s time.</li> </ol>

*This table describes the goals of Taiwan CPA Act revision, summarized from CPA Act Amendment 2007.*

According to legal regulations and professional promulgations in Taiwan, the auditor has a role to express an opinion on the fairness of the presentation of financial statements, which means the financial statements are free of material misstatement. The auditor also holds the professional responsibility towards the audited companies or the specific groups of users of the financial statements. Table 4 summarizes the foregoing description in the legislation and professional guidelines with regards to the responsibility of auditors for fraud detection.

## SOX 2002 IMPACT ON TAIWAN’S ACCOUNTANCY PROFESSION

Influenced by circumstances that led to the passage of SOX, Taiwan’s FSC began to also take a closer look at the string of fraud cases in Taiwan involving publicly listed companies, this self-examination being an attempt to figure out ways of raising CPA audit standards and affecting a robust accountancy system in Taiwan.

As pointed out in the preceding section, one significant SOX reform is to place in the hands of PCAOB the power of regulating standards formerly handled by AICPA. Regrettably, Taiwan accountancy profession today still has not aggressively pursued the idea of employing an outside regulatory agency such as PCAOB to be its supervisor and overseer. It continues to rely for the most part on Taiwan CPA Association’s self-regulatory functions. In fact, one of the highlights of the CPA Amendment Act proposed in 2004 is the fortification of CPA Association’s self-regulating functions through the formation of the “National CPA Federation”, to set standards for implementation of such critical areas as business activity assessment-evaluation, professional ethics & discipline, so that the investing public may be shielded from losses caused by management fraud or audit failure.

In Taiwan, the current audit standards regulating body is still ARDF. As a foundation, ARDF’s limited income derives mainly from selling SAS publications and holding accountant professional training seminars. The pressure of having to seek revenue sources on its own not only hampers ARDF in its



standard-setting efficiency, but also renders it ineffectual when it comes to promoting audit standards toward the direction of public good and interest. This is not conducive to the healthy development of Taiwan’s accountancy profession. In Sarbox, listing companies share the expenses related to the regulation of accounting and audit standards. Not only is this in keeping with the principle of “users pay, nonusers no pay”, the standards so regulated belong to common property and can be freely and widely perused and researched.

Table 4: Summary of Legislation Acts and Professional Guidelines Regarding the Responsibility of Auditor for Fraud

Act/Guideline	Descriptions	Effectiveness
SE Act	(1) CPAs are given the privilege to perform an audit of a company’s financial statements. (2) CPAs are held responsible for the failure to issue a report with respect to any material falsehood in a financial report, due to failure to audit in accordance with applicable laws and regulations and generally accepted audit principles.	1968 - Present
CPA Act	(1) Management and litigation rules for CPAs were set in the articles. (2) CPAs were held responsible for their undue intent or negligence in the performance of the professional services.	1945-2007
CPA Act Amendment 2007	(1) CPAs are held liability for their undue intent or negligence during an audit. (2) The CPA’s independence is strengthened by adding the clear provisions of non-audit service that CPAs are not allowed to perform for an audit-engaged company.	2007-Present
SAS 14: Fraud and Errors	(1) CPAs should plan and perform their audit works with due care so that the material misstatements in the financial reports can be uncovered. (2) Responsibilities for fraud prevention and detection rest with the management of the company	1987-2006
SAS 29: Consideration of Laws and Regulations in an Audit of Financial Statements	(1) CPAs are not and cannot be held responsible for preventing and detecting non-compliance with laws and regulations. (2) CPAs are required to adopt an attitude of due professional care and skepticism with regard to the risk of non-compliance.	1996-Present
SAS 43: The Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statements	(1) CPAs have no fully responsibility to detect fraud but their responsibility goes only as far as certifying whether financial statements overall contained any material misstatements. (2) More precise definition of fraud—employee fraud and management fraud—is given. (3) The certain risk factors causing fraud in the audited company need to be evaluated during an audit.	2006-Present

How the U.S. is able to institutionalize and legalize the revenue sources of a non-self-regulating organization such as PCAOB is a lesson Taiwan can learn from. Until that happens, Taiwan accountants will not be able to reap the benefits of such an overseeing agency the way their U.S. counterparts do.

In part inspired by the passage of the SOX Act in the U.S., Taiwan’s CPA Act Amendment proposals, aside from improving CPA practice environment through the establishment of CPA corporations and the fortification of CPA associations’ structure and functionality, also borrows from SOX such ideas as boosting CPA independence and prescribing severer punishments for CPA faults, while adding its own Taiwan-specific regulations on tightening accountants’ professional qualifications and continuing education requirements, and prescribing more stringent penalties for unlicensed practitioners and those engaged in illicit accountancy trades.

Most importantly, the amendment borrows SOX’s empowerment of PCAOB to conduct inspections of registered CPA firms. The amendment now allows Taiwan’s FSC to send inspectors to investigate these firms’ business and related financial condition. Accounting firms may not dodge, obstruct, or refuse such inspections. It is anticipated that the above measures would in the long run bring about a robust practice environment for Taiwan’s CPAs, boost CPA firms’ interminable operations, raise CPA professional standards, and protect investors’ interests, enabling Taiwan to ultimately hook up with U.S. and international auditing standards. However, just like certain SOX sections are more controversial than others (e.g., 404), some provisions of the CPA Act amendment also sparked more debate than others from among Taiwan accounting professionals, which dealt with CPA certification requirements and penalty

sentencing. In particular, Taiwan CPA Association board chairman Chen Zhao Shen (Huang, 2003) argued that the service nature of accountants differs from professionals such as lawyers and architects; accordingly, the responsibility of each towards society should not be weighed equally. That FSC seeks to minimize societal risk through such regulation is understandable, but responsibility should not place on the shoulders of accountants. “CPAs are not government employees”, he continues, “how can they play the role of exposers and whistle-blowers?” It was also pointed out that listing companies’ replacement of their CPAs itself is ground-breaking news. Making it obligatory for CPAs to divulge the reason behind their refusing certification is a big setback for the business enterprise in question. They claim this FSC regulation is too theoretical and fails to take into consideration practical implementation difficulties.

Further, CPA Association board member Zhang Wei Zhen (Huang, 2003) pointed out that the model this amendment is patterned on was designed for administering listed companies, but over 80% of CPA’s do not handle these FSC-related activities; yet now the framework is encased on *all* CPA’s - this makes it hard for many small-to-mid scale CPA firms to swallow and accept. On these two counts I disagree. The accountancy profession is a very unique one in that the one who pays the CPA (business owner) and the one who reaps the benefit of the CPA’s certification (investing public) are not the same person. The CPA’s role involves public interest - although highly compensated by his commissioner to perform the audit, the CPA cannot shirk from societal responsibility towards the audit consumer. Taiwan accountancy profession must give this some thought - while most accounting firms do not handle business affairs of publicly listed companies, nevertheless, can we therefore complacently assume that financial reports of small-to-mid scale businesses have little to do with the general public? As far as the role of the CPA is concerned, I couldn’t concur more with National Taiwan Cheng-Chi University accounting professor Ma Siu Ru’s analogy when she says: “The CPA’s primary role is that of CPA - to tell investors which companies’ financial reports are sound. Although CPA Association, in expounding the CPA’s role to outsiders, likens it to an ‘entrepreneurial *doctor*’, in actuality, only when a CPA serves as administrative consultant to a business enterprise is he a doctor; as CPA, his role is more appropriately that of an ‘entrepreneurial *policeman*.’” (Huang and Lin 2006)

## DISCUSSION

The Taiwan SAS 14 has remained unchanged until 2006. The standard statement only contained 17 paragraphs, and most of it is normative principles, lack of the details of procedures for fraud audit. However, auditing standards with regard to CPA’s responsibility for fraud and errors changed. The public at large gave clear indications that they regarded the previous auditing standard as sub-standard. The accountancy profession responded by increasing the audit requirements in an attempt to bridge the expectation gap. On September 2006, Taiwan ASC issued the new SAS 43 under the recommendation by FSC in response of a series of corporate fraud from the year 2000. CPAs have a responsibility to detect fraud only if the fraud may cause the financial statements to be materially misstated. The responsibility to detect material fraud is not explicitly included in the Taiwan auditing guidelines. However, the Taiwan regulatory bodies and government severely criticized the audit function due to numerous company failures and material fraud cases that remained undetected. However, it is expected of the CPA to issue a CPA’s opinion about the true and fair (“fairly presented” in Chinese terms) presentation of the financial statements and results of company operations. It can be referred whether or not CPAs have the responsibility to detect material misstatements of the financial statements due to fraud or errors is questionable.

In the past, Taiwan accountancy profession has allowed a rather significant audit expectation gap to exist (Ma, 2006a), but following the outbreak of the Enron incidents and the passage of SOX, the profession realized that the price such an expectation gap exacts ultimately had to be shouldered by accountants themselves, so recent auditing standards were designed to narrow such gap. The expanded SAS 43 of

2006, replacing the outdated SAS 14, was one step in this direction. Its main objective is summed up in its title: “The CPA’s Responsibility to Consider Fraud in an Audit of Financial Statements.” SAS 43 attempts to narrow the investing public’s expectation gap as far as the CPA’s fraud detection responsibilities are concerned, by communicating to them the following (Ma, 2006b):

*“In their audit of financial statements, CPAs have a responsibility towards detecting fraud, but, in the event that they are unable to detect it, CPAs are not necessarily held responsible in the end. Whether or not they must take ultimate responsibility depends on whether they dutifully conformed to Generally Accepted Auditing Standards (GAAS) and were able to present evidence of this conformity, i.e. the audit work paper records. Naturally, circumstances surrounding auditee’s commission of fraud are also prime considerations. These include: tactics used, position held, accomplices’ degrees of involvement and with regard to faking account figures - the frequency, scope, dollar amount, etc”.*

From its wording, one can readily see that SAS 43 lets accountants assume the responsibility of audit failure; however, business enterprise collapse caused by company management’s malfunctioning internal control system is *not* part of that responsibility. By pointing out this distinction between audit failure and corporate failure, SAS 43’s intent is clear- to rectify the public’s conception, rather, misconception, of the audit function. Thus, instead of aligning audit objectives to public expectations, SAS 43 is designed in a way to manage the expectation gap on Taiwan accounting profession’s own terms, as it is widely accepted that one way to narrow this gap is through education and exposure, so that financial statement users and the public do not have an overblown view of the audit function.

As mentioned above, the role played by the accountant during the audit process is that of a watchdog, not a doctor. When a CPA completes his audit report, he is in effect making a *second* declaration (the report itself) to establish the accuracy of the *first* declaration (the one made by company management, namely the financial statements). This he declares to the investing public- he himself is not offering new information, but merely raising the credibility of old information supplied to him. But with more and more complex operating environment and transaction modes, CPAs today really need a deeper understanding and insight into corporate management’s motives, circumstances, and tactics when it comes to fraudulent financial statements. An external CPA who understands the special business and operating nature of the client he serves can better design the proper audit procedure and gather the appropriate audit evidence. This has always been a major challenge for Taiwan CPAs engaged in audit work.

The predicament Taiwan accountancy profession finds itself in today is not unique to Taiwan; it is a widespread worldwide phenomenon. Following the 2004 Procomp Informatics fraud incident, the Taiwan government and accountant supervisory agency, no different from other countries’ response to Enron, scrambled to restore public confidence in the accounting profession. To four of Procomp’s past and present engagement CPAs, the then newly formed FSC meted out its severest penalty: 2-year suspension (FSC 2005). At the same time, it began to call for a serious look into the CPA Act and corporate governance.

Meanwhile, the Taiwan accountancy profession continues to find ways to reduce the expectation gap. Admittedly, some of the suggested measures have already been tried out in other countries. One, for example, involves tightening the internal control system of publicly listed companies, the argument being that, since the role a CPA plays in certifying company financial statements is not one of internal audit, and in reality it is not possible for him to offer a 100% assurance of the auditee’s overall financial reporting system. The key to financial statements’ veracity and accuracy lies in the preparers of these company documents themselves. If strong corporate governance is in place, the company’s board oversees management functions and holds management fraud intentions in check. When the occasion

calls for it, board and company CEO can effectively intervene and present authentic company financial statements.

Another suggestion made is to strengthen both Taiwan accountancy profession self-regulation as well as non-self-regulation. To accomplish the latter, an external independent supervisory agency must be established to oversee Taiwan's accounting industry, its powers to include setting audit and accounting standards that align with public expectations. To accomplish the former, Taiwan CPA Association's various committees must not just be comprised of accounting professionals but include distinguished members from diverse sectors of society. Through their involvement, financial statement audit procedures can be made more transparent and public awareness heightened, so that CPAs in their financial audit and standards-setting capacities can, while functioning under a self-regulatory institution, better conform to the principles of what is termed "commonly accepted".

SAS 43, issued in September 2006, has at least been around for over a year. In contrast, Taiwan's CPA Act Amendment, though passed by the Executive Yuan in 2004, was not enacted into legislation by Taiwan's Congress until December 2007, so its effects will not be felt for some time. In particular, under the new amendment, FSC, a governmental agency, is now empowered to send its delegated inspectors to carry on investigations of accounting firms. Ostensibly to put the public's mind to rest that questionable firms and fraud perpetrators will be eventually brought to justice, one might reasonably put two and two together and question whether this might be an attempt on the part of the state to intervene, in the hope that the audit expectation gap may be held in check. Unfortunately, given its brief period of enforcement, it is too premature at this point in time to assess the amendment's repercussions in this respect. Taking into consideration the unique business and political conditions in Taiwan, and how rapid the political atmosphere in Taiwan can change, especially with the new president elected in March, 2008, only a repeat research study at a later time can actually confirm any of these speculations.

## SUMMARY

In relation to the CPA's responsibility to detect fraud, the audit expectations gap is at its widest when CPAs are unable to discover the financial statements fraud or malpractice during their audit. Clamoring cries of "Where was the CPA?" infer that, by failing to discover significant fraud, he could not have done his job properly.

According to the accountancy profession, the auditor's report is the prime reporting vehicle used by CPAs to inform the users of financial statements about the results of the audit. In the report, the CPA included his opinion on the fairness of the presentation of financial statements. This is the public role of CPAs. The CPA has also a private role, the professional responsibility towards the audited companies or the specific groups of users of the audited financial statements. If the financial statements contained material misstatements which may be the result of fraud, the CPA should qualify his opinion on these financial statements. In fact, according to the accountancy profession, the CPA's report is normally issued after the completion of the audit work. If fraud or an illegal act has occurred, the CPA's report may be released too late to establish an early warning. Therefore, a legal early warning system where CPAs have to communicate directly to the government may facilitate the prosecution of potential fraud or illegal activities.

Legislation and professionally promulgated auditing guidelines with regard to the responsibilities of CPAs for fraud in Taiwan were discussed in the paper. It is argued that CPAs have no explicit responsibility to prevent fraud, but it is CPAs' responsibility to detect material misstatements of financial statements due to fraud. The focus is merely on how CPAs issue an opinion about the true and fair presentation of the financial statements and the results of the company's operations.

Unlike the early 20<sup>th</sup> century, which placed CPA responsibilities primarily on detecting financial statement errors and fraud within the corporation (Porter, 1997), toward the end of the 20<sup>th</sup> century, such responsibilities have shifted to attesting the “true and fair” presentation of the financial statements. Humphrey *et al* (1993) suggested that the changes in CPA responsibilities are “reflective of the conflicting, political nature of a self-regulated accounting profession”. The phenomenon of downplaying CPAs’ responsibilities by the accounting profession resulted from its pursuit of professional interests and its attempts to manage the interplay between its own interests and any competing public responsibilities and obligations (Humphrey *et al* 1993, Power 1995). This downplayed responsibility made it seemingly impossible to eliminate expectations gap. If this gap continues to broaden to the point when public trust buckles, that would signify the start of the breakdown of capital market and credibility of accountancy profession.

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