

Chapter 2

The structure of the profession

Learning objectives

- 2.1 Identify the attributes of professional status and describe to what extent they exist in public accounting.
 - 2.2 Describe the regulation of auditing and its subject matter.
 - 2.3 Explain the impact of internationalisation on auditing.
 - 2.4 Outline the characteristics of the professional bodies and accounting firms engaged in the auditing profession and describe the internal structure of an audit firm.
 - 2.5 Identify the elements of quality control within audit firms and explain practice-monitoring programs.
 - 2.6 Explain how auditing in the public sector fits into the Australian auditing and assurance environment.
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Major chapter sections

Professional status of the auditor
Regulation of auditing and of the subject matter of audits
Internationalisation of auditing
Profile of the auditing profession and of audit firms
Quality control
Auditing in the public sector

Lecture plan

Since many students are interested in a career in public accounting, we normally spend some time covering the items in this section. In particular, we like to go over the status of auditing as a profession and the role of government and professional associations in the auditing and assurance services environment.

Learning objective 2.1: Professional status of the auditor

It is important that students realise that auditing is a profession and, therefore, like all professions, must exhibit the attributes of systematic theory, professional authority, community sanction, regulative codes and culture.

[Use slides 2-3 and 2-4]

Learning objective 2.2: Regulation of auditing and of the subject matter of audits

It should be pointed out to students that the audit and assurance function is carried out in a complex environment, composed of interrelationships between government and professional organisations and individual auditors and audit firms. Students should be made aware of the main government and independent agencies that regulate auditing and the subject matter of audits, and the role played by the accounting bodies.

[Use slides 2-5 to 2-11]

Learning objective 2.3: Internationalisation of auditing

Business is now conducted globally and this has contributed to the development of international auditing practices. Introducing students to the importance of the global environment at this early stage prepares them for considering this aspect in relation to client business risk later on.

[Use slides 2-12 to 2-14]

Learning objective 2.4: Profile of the auditing profession and of audit firms

We review the three key professional accounting bodies that dominate the auditing profession in Australia. We then briefly review the structure of firms (e.g. sole trader, partnership or authorised audit company), the categorisation of firms (e.g. Big 4, national firms, regional firms and local firms) and the types of services (e.g. audit, tax, management consulting, internal audit, accounting and insolvency services) that are offered by public accounting firms. Also, students are interested in the internal structure of an audit firm.

[Use slides 2-15 to 2-21]

Learning objective 2.5: Quality control

Students should be made aware at this stage that quality control procedures are essential to ensure auditors meet their responsibilities. We discuss the overall requirements of ASA 220 (ISA 220), ASQC 1 (ISQC1) and APES 320 and the key quality control procedures used by the professional accounting bodies, including practice reviews and professional development.

[Use slides 2-22 and 2-26]

Learning objective 2.6: Auditing in the public sector

We give students a brief introduction to auditing in the public sector, which will be considered in more detail later on in Chapter 15.

[Use slide 2-27]

Summary

We provide a summary slide of the main learning takeaways in this chapter.

[Use slide 2-28]

SOLUTIONS

Chapter 2: The structure of the profession

REVIEW QUESTIONS

- 2.1** (a) C High fees are not a requirement for a profession.
- (b) D Attributes of a profession include systematic theory, professional authority, community sanction, regulative codes and culture.
- 2.2** (a) B To have sufficient auditing experience an auditor must have completed at least 3000 hours of work in auditing during the five years immediately prior to the date of their application, including at least 750 hours spent supervising audits of companies.
- (b) C Resignation from an audit is not grounds for disciplinary action against an auditor.
- 2.3** (a) A Membership of the International Federation of Accountants is open to accountancy bodies.
- (b) D Members of the Forum of Firms must conform to the Forum of Firms Quality Standards, subject themselves to global peer review, and perform audits of financial reports that may be used across national borders.
- 2.4** (a) B CPA Australia is the largest accounting body in Australia.
- (b) D Audit firms may practise as sole traders, partnerships or authorised audit companies.
- 2.5** (a) C A system of quality control should provide reasonable assurance that a firm's personnel comply with all professional standards applicable to its audit and assurance services practice.
- (b) A The purpose of professional development is to ensure that auditors maintain and update their knowledge.
- 2.6** (a) B External audits in the public sector are the responsibility of the relevant Auditor-General.
- (b) D Audit mandates in the public sector include financial report audits, performance audits and compliance audits.
- 2.7** The essential attributes of a profession are systematic theory, professional authority, community sanction, regulative codes and a culture. The auditing profession satisfies these essential attributes.
- *Systematic theory.* The underlying theory of the auditing profession consists of auditing theory and accounting theory. Knowledge of systematic theory can be achieved best through formal education in an academic environment. A tertiary education is considered a prerequisite for people entering the auditing profession. They are then required to complete the education program of one of the three accounting bodies (Chartered Accountants Program, CPA Program or NIA Program) and to undertake continuing professional development throughout their audit career.

- *Professional authority.* To be a registered company auditor a person must, among other things, be a member of one of the accounting bodies discussed in this chapter or another prescribed body, each of which controls admission to their own organisation.
- *Community sanction.* In Australia, registered company auditors have been granted a monopoly on rendering external auditor's opinions on the financial reports of companies.
- *Regulative codes.* Regulation of the auditing profession is directed at two areas: technical and ethical. Auditing standards govern the technical work of the auditor, while the ethical rules govern the auditor's behaviour.
- *Culture.* Auditors are expected to behave in a way that is in accord with the Code of Ethics for Professional Accountants, including exhibiting integrity, independence, objectivity and confidentiality and acting in the public interest. New members of the profession must learn what is expected of them or they will not be accepted as colleagues by their associates.

2.8 The role of the AUASB is to develop and maintain auditing and assurance standards. It was established as an independent statutory body following CLERP 9 to establish its independence from the auditing profession and thus to give more credibility to its standards.

2.9 ASIC is responsible for uniformity in the administration of legislation in relation to companies and for policy based on investor protection. The audit of reporting entities in Australia can be performed only by independent auditors who are registered with ASIC through the Companies' Auditors and Liquidators Disciplinary Board. The criteria for registration of auditors are contained in section 1280 of the *Corporations Act 2001*, which prescribes that a person applying for registration must:

- be an ordinary resident in Australia
- be a member of an approved accounting body
- be a graduate of a prescribed tertiary institution
- have sufficient auditing experience
- be a fit and proper person.

2.10 (a) A member of the ICAA, CPA Australia or the IPA may be disciplined if they have:

- been guilty of any breach of their charter, constitution, by-laws or pronouncements
- been guilty of dishonourable practices or conduct derogatory to the profession of an accountant or conduct that is not in the best interests of that body or its members
- failed to observe a proper standard of professional care, skill and competence
- become insolvent under administration.

- (b) The accounting bodies have disciplinary procedures that include the right to impose forfeiture of membership, suspension from membership, fines, censure or admonishment on any member found guilty of unprofessional conduct.
- 2.11** The FRC oversees the setting of accounting standards, auditing standards and auditor independence. The AASB is responsible for setting accounting standards that set out the way subject matter must be dealt with in the financial report.
- 2.12** IFAC is made up of accountancy bodies around the world and, through the IAASB and its other committees, sets international auditing standards, ethical rules and quality control procedures.
- 2.13** IOSCO is the International Organization of Securities Commissions, and it has pushed strongly for the adoption of international auditing standards for the audit of companies listed on world securities exchanges.
- 2.14** There are three major professional accounting bodies in Australia: the Institute of Chartered Accountants in Australia (ICAA), CPA Australia and the Institute of Public Accountants (IPA). Membership of any of these bodies by public accounting practitioners, although voluntary, is necessary to satisfy the qualification element of the registration of auditors. To maintain membership of these bodies, members are required to engage in continuous professional development. Membership of these bodies provides for the setting of standards of competence in the accounting and auditing professions, and enables partial self-regulation. These bodies represent the interests of accountants and auditors with government and other groups, and are responsible for the development and advancement of the accounting and auditing profession in Australia and overseas. Members of the accounting bodies are represented on the key standard-setting bodies, such as the AUASB, AAASB and APESB.
- 2.15** The auditing profession is made up of diverse firms ranging from large international firms to individual sole practitioners. One common classification is international firms; national firms; and regional and local firms.
- 2.16** Matters that need to be included in the audit firm's policies and procedure under ASQC 1.32 (ISQC 1.32) are:
- matters relevant to promoting consistency in the quality of engagement performance (paragraphs A32–A33)
 - supervision responsibilities (paragraph A34)
 - review responsibilities (paragraph A35).

- 2.17** The ICAA, CPA Australia and the IPA conduct quality review programs. The reviewers consider the policies and procedures established by the member to ensure compliance with professional standards, and review client files.
- 2.18** Continuing professional development is important to ensure that accountants maintain and update their knowledge.
- 2.19** The public sector includes three levels of government—Commonwealth; state and territory; and local—and includes ministries and departments, statutory authorities, local government councils and other public bodies, some of which may update as business undertakings and companies. The private sector includes non-government organisations such as sole traders, partnerships, trusts and companies. The role of the auditor in each sector depends on the legislation or reason for the audit, the nature of the audit to be conducted and the party to whom the auditor is reporting.

DISCUSSION PROBLEMS AND CASE STUDIES

2.20 EASY

Points that should be raised in a discussion on this issue include:

- possible detrimental effects on the credibility of the profession
- possible confusion in the minds of the public
- the public being unable to rely on the skill levels of accountants without further inquiry
- regulators and policymakers being unaware of the appropriate body with which to discuss accounting issues
- allowing for the influx of new ideas/talent in accounting that might otherwise be considered a ‘closed shop’ arrangement
- the question of how accountants should be defined as a profession—should they be required to possess the five identified characteristics of a profession or membership of prescribed bodies?
What effect would this have on commercial accountants?

2.21 MEDIUM

The accounting bodies have disciplinary procedures supported by adequate potential sanctions, including fines, suspension and cancellation of membership. However, there have been few instances of the more serious sanctions being applied. One difficulty has been that in serious cases the accounting bodies’ by-laws require that they wait until after court cases or ASIC investigations have been completed, including all appeal processes. By that stage any action by the accounting bodies might be of little consequence. There is an argument that the accounting bodies need to take action earlier and be seen to take stronger action.

2.22 MEDIUM

The globalisation of business and increased international trade have contributed to the development of international auditing practices. There is a worldwide move towards harmonisation and convergence of international accounting and auditing standards. Most countries carefully consider the International Standards on Auditing (ISAs), issued by the International Auditing and Assurance Standards Board (IAASB), when developing their own standards. IAASB is an independent body that develops standards and guidance for audit and assurance services. In Europe and Australia, international accounting and auditing standards have been adopted since 2005. The International Federation of Accountants (IFAC) supports IAASB and guides efforts to develop technical (accounting and auditing) and ethical standards. Members include 167 accounting bodies (including the ICAA, CPA Australia and the IPA) in 127 countries. It has made considerable progress towards the adoption of the international auditing standards by member bodies. IFAC has been supported in this role by the International Organization of Securities Commissions (IOSCO). Endorsement from IOSCO will mean that securities exchanges around the world will accept financial reports and other documents that have been prepared and audited in accordance with international standards.

2.23 EASY

As a result of the CLERP 9 amendments to the *Corporations Act 2001*, auditors can now apply to be an authorised audit company under section 1299A of the Act. However, to be eligible to be an authorised audit company, section 1229B requires that each director of the audit company be a registered company auditor, each share must be held and beneficially owned by an individual or their legal representative, that the majority of the voting power be in the hands of registered company auditors and that the company have adequate professional indemnity insurance and not be externally administered.

The main implication of this amendment is that auditors in an authorised audit company now have limited liability—that is, they are no longer personally liable for their professional services. The personal assets of the auditors are no longer at risk in the event of a legal claim. However, as stated above, the audit company is required to maintain adequate professional indemnity insurance.

2.24 MEDIUM

Arguments for using a team structure include the following.

- It allows for onsite training of staff.
- It ensures proper supervision of staff.
- It is efficient, as less complex tasks can be delegated to more junior staff, allowing partners and managers to concentrate on areas of high risk.
- It ensures that the final opinion is supportable, as evidence is often considered by a number of individuals prior to determining the auditor's opinion.

Arguments against using a team structure include the following.

- The internal audit department could more efficiently perform the majority of simple tasks with work reviewed by senior staff.
- The full review process might add little value to the audit evidence. Research suggests that the majority of points raised at the assistant to senior level were of an administrative nature.
- Many of the issues are now too complex for staff with little experience to understand (this is a Catch-22 argument, however, as staff only get experience by doing the work).

2.25 EASY

Quality control procedures work together to ensure the quality of the services offered by the practice and as such should not be considered as a set of options from which a practice can choose. Instead, each firm should look to the general policies and procedures set out in ASA 220 (ISA 220), APES 320 and ASQC 1 (ISQC 1) and determine how best to implement those procedures in their firm. While some firms may decide to devote more resources to certain areas (such as training) in order to bring them up to standard and to maintain that standard, no one policy is more important than any other.

2.26 MEDIUM

The objective of the accounting bodies' quality control programs is to ensure that accounting practices maintain a consistently high standard of quality and service to their clients and conform to professional standards. The application of the principles of quality control helps an accounting practice to identify areas for improvement or opportunities to provide better service in conducting technical client engagements.

The objectives of quality control remain the same for all accounting practices, but the size of the firm and the types of engagements it undertakes will affect how these objectives are achieved.

2.27 MEDIUM

The auditing standards apply to all audit and audit-related services, irrespective of the size of the firm. ASA 220 (ISA 220) states that the audit firm should implement quality control policies and procedures at both audit firm level and individual audit level. If it does this, the new firm will ensure that it complies with professional standards. The underlying objective of professional standards, as stated in APES 320 and ASQC 1 (ISQC 1), is that the new firm will consider the integrity of individuals when determining its professional relationships and will be independent to the extent required by the ethical rules, and that the practice will assure itself that its personnel will be competent and objective and will exercise due professional care.

APES 320 and ASQC 1 (ISQC 1) also require that the objectives of the quality control policies to be adopted by the firm incorporate:

- leadership responsibilities for quality within the firm
- ethical requirements
- acceptance and continuance of client relationships and specific engagements

- human resources
- engagement performance
- monitoring.

Of course, the nature and extent of the new firm's quality control will be affected by the size and the nature of the services offered.

The quality control policies and procedures must be adequately vetted documents, by means of preparing either:

- a quality control document that provides a detailed description of the policies and procedures, or
- a summary statement of the quality control policies and procedures with references to supporting information contained in manuals, memoranda or other technical literature of the practice.

These policies and procedures should be reviewed on a continuing basis.

2.28 HARD

- Under APES 320.AUST109 and ASQC 1.A66 (ISQC 1.A66), the firm must inspect at least one engagement for each engagement partner over an inspection cycle, which ordinarily spans no more than three years. Note that a periodic inspection of a selection of completed documents is a mandatory requirement of APES 320.106. In this scenario, inspection occurs every five years.
- Under APES 320.89–90 and ASQC 1.43–44 (ISQC 1.43–44), the firm must establish policies and procedures for dealing with and resolving differences of opinion within the engagement team. In this scenario, it appears that there are no documented procedures for dealing with disagreements, as the lead partner sided with the senior auditor without a formal discussion of the matter.
- Under APES 320.24 and ASQC 1.21 (ISQC 1.21), firms are required to communicate independence requirements to personnel, and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level. In this scenario, it appears that G&H is not communicating independence requirements to staff, although it is identifying threats to independence (though perhaps not with sufficient regularity). It is essential for G&H to implement the staff training and ensure that the threats to independence are reviewed more regularly.

Under APES 320.14 and ASQC 1.18 (ISQC 1.18), the firm's leadership is responsible for the quality control and, as such, although they may seek outside consultants' advice and input, they should be aware of the requirements and be satisfied that the consultants have incorporated all the appropriate facts and requirements for their particular firm. The quality control policies and procedures need to be current and regularly reviewed—if this exercise was done two years ago, the partners should be reviewing it to ensure that it complies with the latest requirements.

Under APES 320.15 and ASQC 1.A4 (ISQC 1.A4), the ‘tone at the top’ is important, and the firm’s leadership must communicate messages regarding quality control to all levels within the firm through training seminars, formal dialogue, newsletters and so on. Currently the firm does not seem to be providing training in this area.

2.29 HARD

- (a) Under APES 320.119 and ASQC 1.55 (ISQC 1.55), firms must establish policies and procedures for dealing with complaints and allegations relating to non-compliance with professional standards. It appears from the scenario that there are no policies and procedures in place, since the partner is unsure of what to do.

Under APES 320.121 and ASQC 1. A71 (ISQC 1.A71), clearly defined channels are required for the communication of complaints and allegations, and the complaint must be supervised by an appropriate person who was not involved in the audit, and may include seeking legal counsel.

- (b) Under APES 320.44 and ASQC 1.28 (ISQC 1.28), firms must have a documented procedure for dealing with information that, had it been obtained earlier, would have caused it to decline a client engagement. In this scenario, the fact that the partners did not know what to do implies that there is no documented guidance. The firm should have documented guidance dealing with a wide variety of plausible independence threats.

APES 320.38 and ASQC 1.26 (ISQC 1.26) state that procedures for the acceptance and continuance of client relationships must be established, and that such procedures provide the firm with reasonable assurance that the client’s integrity has been assessed and is acceptable.

The firm should also consider whether it has any responsibility to report the client to an authority, and should consider the possibility of withdrawing from the engagement.

- (c) There are a number of potential reasons for the inconsistency of time it takes to assemble the final engagement file, but the most likely scenario is that there are no policies or procedures in place. Other possibilities are that the policies and procedures are simply not being followed or are not being communicated.

Under APES 320.93 and ASQC 1.45 (ISQC 1.45), firms must establish policies and procedures for the assembly of final engagement files on a timely basis after the engagement reports have been finalised. Either the firm needs to develop policies and procedures or, if they already exist, ensure that they are properly communicated. Where no time limits are prescribed by law or regulation, APES 320.94 and ASQC 1.A54 (ISQC 1.A54) state these must be established by the firm, but would not ordinarily be more than 60 days after the date of the auditor’s report.

2.30 MEDIUM

- (a) The qualifications required to work as an auditor in the public sector are the same as those required in the private sector.

- (b) Responsibility for public sector audits rests with the Commonwealth and state Auditors-General. However, public sector audits still should be performed in accordance with Australian auditing standards, which should be applied to the extent that they are not inconsistent with or unnecessary to public sector audit mandate.

Financial report audits will be required for all public sector entities. In addition, compliance and performance audits may also be required to a much greater extent than in the private sector.