

Chapter 2

The CPA Profession

■ Review Questions

2-1 The four major services that CPAs provide are:

1. *Audit and assurance services* Assurance services are independent professional services that improve the quality of information for decision makers. Assurance services include attestation services, which are any services in which the CPA firm issues a report that expresses a conclusion about the reliability of an assertion that is the responsibility of another party. The four categories of attestation services are audits of historical financial statements, attestation on the effectiveness of internal control over financial reporting, reviews of historical financial statements, and other attestation services.
2. *Accounting and bookkeeping services* Accounting services involve preparing the client's financial statements from the client's records. Bookkeeping services include the preparation of the client's journals and ledgers as well as financial statements.
3. *Tax services* Tax services include preparation of corporate, individual, and estate returns as well as tax planning assistance.
4. *Management consulting services* These services range from suggestions to improve the client's accounting system to computer installations.

2-2 The major characteristics of CPA firms that permit them to fulfill their social function competently and independently are:

1. *Organizational form* A CPA firm exists as a separate entity to avoid an employer-employee relationship with its clients. The CPA firm employs a professional staff of sufficient size to prevent one client from constituting a significant portion of total income and thereby endangering the firm's independence.
2. *Conduct* A CPA firm employs a professional staff of sufficient size to provide a broad range of expertise, continuing education, and promotion of a professional independent attitude and competence.
3. *Peer review* This practice evaluates the performance of CPA firms in an attempt to keep competence high.

2-3 The Public Company Accounting Oversight Board provides oversight for auditors of public companies, including establishing auditing and quality control standards for public company audits, and performing inspections of the quality controls at audit firms performing those audits.

2-4 The purpose of the Securities and Exchange Commission is to assist in providing investors with reliable information upon which to make investment decisions. Since most reasonably large CPA firms have clients that must file reports with the SEC each year (all companies filing registration statements under the securities acts of 1933 and 1934 must file audited financial statements and other reports with the SEC at least once each year), the profession is highly involved with the SEC requirements.

The SEC has considerable influence in setting generally accepted accounting principles and disclosure requirements for financial statements because of its authority for specifying reporting requirements considered necessary for fair disclosure to investors. In addition, the SEC has power to establish rules for any CPA associated with audited financial statements submitted to the Commission.

2-5 The AICPA is the organization that sets professional requirements for CPAs. The AICPA also conducts research and publishes materials on many different subjects related to accounting, auditing, management advisory services, and taxes. The organization also prepares and grades the CPA examinations, provides continuing education to its members, and develops specialty designations to help market and assure the quality of services in specialized practice areas.

2-6 *Statements on Standards for Attestation Engagements* provide a framework for attest engagements, including detailed standards for specific types of attestation engagements.

2-7 The PCAOB has responsibility for establishing auditing standards for public companies, while the Auditing Standards Board (ASB) of the AICPA establishes auditing standards for private companies. The ASB previously had responsibility for establishing auditing standards for both public and private companies. Existing auditing standards were adopted by the PCAOB as interim auditing standards for public company audits.

2-8 *Generally accepted auditing standards* are ten general guidelines to aid auditors in fulfilling their professional responsibilities. These guidelines include three general standards concerned with competence, independence, and due professional care; three standards of field work including planning and supervision, understanding the entity and its environment, including its internal control, and the gathering of sufficient appropriate evidence; and four standards of reporting, which require a statement as to presentation in accordance with generally accepted accounting principles, inconsistency observed in the current period in relation to the preceding period, adequate disclosure, and the expression of an opinion as to the fairness of the presentation of the financial statements.

Generally accepted accounting principles are specific rules for accounting for transactions occurring in a business enterprise. Examples may be any of the opinions of the FASB.

2-9 Auditors can obtain adequate technical training and proficiency through formal education in auditing and accounting, adequate practical experience, and continuing professional education. Auditors can demonstrate their proficiency by becoming licensed to practice as CPAs, which requires successful completion of the Uniform CPA Examination. The specific requirements for licensure vary from state to state.

2-10 For the most part, generally accepted auditing standards are general rather than specific. Many practitioners along with critics of the profession believe the standards should provide more clearly defined guidelines as an aid in determining the extent of evidence to be accumulated. This would eliminate some of the difficult audit decisions and provide a source of defense if the CPA is charged with conducting an inadequate audit. On the other hand, highly specific requirements could turn auditing into mechanical evidence gathering, void of professional judgment. From the point of view of both the profession and the users of auditing services, there is probably a greater harm from defining authoritative guidelines too specifically than too broadly.

2-11 International Standards on Auditing (ISAs) are issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). ISAs are designed to improve the uniformity of auditing practices and related services throughout the world by issuing pronouncements on a variety of audit and attest functions and promoting their acceptance worldwide. A CPA who conducts an audit in accordance with GAAS may not comply with ISAs because there may be additional ISA requirements that extend beyond GAAS requirements.

2-12 Quality controls are the procedures used by a CPA firm that help it meet its professional responsibilities to clients. Quality controls are therefore established for the entire CPA firm as opposed to individual engagements.

2-13 The element of quality control is personnel management. The purpose of the requirement is to help assure CPA firms that all new personnel are qualified to perform their work competently. A CPA firm must have competent employees conducting the audits if quality audits are to occur.

2-14 A peer review is a review, by CPAs, of a CPA firm's compliance with its quality control system. A mandatory peer review means that such a review is required periodically. AICPA member firms are required to have a peer review every three years. Registered firms with the PCAOB are subject to quality inspections. These are different than peer reviews because they are performed by independent inspection teams rather than another CPA firm.

Peer reviews can be beneficial to the profession and to individual firms. By helping firms meet quality control standards, the profession gains if reviews result in practitioners doing higher quality audits. A firm having a peer review can also gain if it improves the firm's practices and thereby enhances its reputation and effectiveness, and reduces the likelihood of lawsuits. Of course peer reviews are costly. There is always a trade-off between cost and benefits.

2-15 Firms may belong to Center for Audit Quality and the Private Companies Practice Section (PCPS) Firm Practice Center. The mission of the Center for Audit Quality is to foster confidence in the audit process and to aid investors and the capital markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty and trust. The PCPS Firm Practice Center provides practice management resources for firms of all sizes.

In addition to these resource centers, the AICPA also provides the Governmental Audit Quality Center and Employee Benefit Plan Audit Quality Center to provide resources for performing quality audits in these unique and complex audit areas.

■ Multiple Choice Questions From CPA Examinations

2-16 a. (1) b. (2) c. (3) d. (3)

2-17 a. (2) b. (1) c. (2) d. (3)

■ Discussion Questions And Problems

2-18 a. The comments summarize the beliefs of many practitioners about the Sarbanes–Oxley Act and the PCAOB. The arguments against the Act can be summarized as four arguments:

1. Costs of complying with the Act are excessively high, especially the requirement to report on internal control over financial reporting, and will discourage companies from becoming public companies.
2. Relative cost for local audit firms is excessively high.
3. Additional oversight is not needed because sufficient quality controls have already been implemented by most audit firms.
4. Three other things already provide assurance of adequate quality: a competitive economic environment, legal liability, and auditing standards.

To support these comments, it can be argued that the profession has generally functioned well with relatively little controversy and criticism.

The arguments against these comments are primarily as follows:

1. Reporting on the effectiveness of internal control over financial reporting will provide benefits in improved controls, resulting in higher quality financial reporting and reduced losses from fraud.
2. The increased confidence in financial reporting will increase access to capital and lower the cost of capital by reducing information risk.

2-18 (continued)

- 3. Changes in the scope of CPA practices and other threats to audit quality required government regulation.
 - 4. Regulation of public company audits will not affect most audit firms that do not have public company audit clients.
- b. There is no correct answer to this question. Different people reach different conclusions, depending on the weights put on the various arguments. Time is needed to effectively assess both the costs and benefits of the Act.

- 2-19**
- a. Engagement performance
 - b. Human resources
 - c. Engagement performance
 - d. Engagement performance
 - e. Relevant ethical requirements
 - f. Monitoring
 - g. Acceptance and continuation of clients and engagements
 - h. Human resources
 - i. Human resources
 - j. Leadership responsibilities

- 2-20**
- a. Rossi and Montgomery's primary ethical consideration is their professional competence to perform all of the audit work for filing with the SEC. In addition, if Rossi and Montgomery have performed bookkeeping services or certain consulting services for Mobile Home, they will not be independent under PCAOB and SEC independence requirements. The firm must also be a registered firm with the PCAOB.
 - b. The filing with the SEC, in addition to normal audited financial statements, will require completion and registration with the SEC of Form S-1 which includes an audited summary of operations for the last five fiscal years as well as many additional schedules and descriptions of the business. Each quarter subsequent to the filing, Form 10-Q must be filed; and within 90 days of the end of each fiscal year Form 10-K must be filed with the SEC.
In addition, Form 8-K must be filed whenever significant events have occurred which are of interest to public investors. These forms must be filed in conformity with Regulation S-X, which requires considerable disclosures in addition to those normally required in audited financial statements.

BRIEF DESCRIPTION OF GAAS	HOLMES' ACTIONS RESULTING IN FAILURE TO COMPLY WITH GAAS
GENERAL STANDARDS	
<p>1. The auditor must have adequate technical training and proficiency to perform the audit.</p>	<p>1. It was inappropriate for Holmes to hire the two students to conduct the audit. The audit must be conducted by persons with proper education and experience in the field of auditing. Although a junior assistant has not completed his formal education, he may help in the conduct of the audit as long as there is proper supervision and review.</p>
<p>2. The auditor must maintain independence in mental attitude in all matters relating to the audit.</p>	<p>2. To satisfy the second general standard, Holmes must be without bias with respect to the client under audit. Holmes has an obligation for fairness to the owners, management, and creditors who may rely on the report. Because of the financial interest in whether the bank loan is granted to Ray, Holmes is independent in neither fact nor appearance with respect to the assignment undertaken.</p>
<p>3. The auditor must exercise due professional care in the performance of the audit and the preparation of the report.</p>	<p>3. This standard requires Holmes to perform the audit with due care, which imposes on Holmes and everyone in Holmes' organization a responsibility to observe the standards of field work and reporting. Exercise of due care requires critical review at every level of supervision of the work done and the judgments exercised by those assisting in the audit. Holmes did not review the work or the judgments of the assistants and clearly failed to adhere to this standard.</p>

2-21 (continued)

BRIEF DESCRIPTION OF GAAS	HOLMES' ACTIONS RESULTING IN FAILURE TO COMPLY WITH GAAS
STANDARDS OF FIELD WORK	
1. The auditor must adequately plan the work and must properly supervise any assistants.	1. This standard recognizes that early appointment of the auditor has advantages for the auditor and the client. Holmes accepted the engagement without considering the availability of competent staff. In addition, Holmes failed to supervise the assistants. The work performed was not adequately planned.
2. The auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures.	2. Holmes did not obtain an understanding of the entity or its internal control, nor did the assistants obtain such an understanding. There appears to have been no audit at all. The work performed was more an accounting service than it was an auditing service.
3. The auditor must obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit.	3. Holmes acquired no evidence that would support the financial statements. Holmes merely checked the mathematical accuracy of the records and summarized the accounts. Standard audit procedures and techniques were not performed.
STANDARDS OF REPORTING	
1. The auditor must state in the auditor's report whether the financial statements are presented in accordance with generally accepted accounting principles (GAAP).	1. Holmes' report made no reference to generally accepted accounting principles. Because Holmes did not conduct a proper audit, the report should state that no opinion can be expressed as to the fair presentation of the financial statements in accordance with generally accepted accounting principles.

2-21 (continued)

BRIEF DESCRIPTION OF GAAS	HOLMES' ACTIONS RESULTING IN FAILURE TO COMPLY WITH GAAS
2. The auditor must identify in the auditor's report those circumstances in which such principles have not been consistently observed in the current period in relation to the preceding period.	2. Holmes' improper audit would not enable him to determine whether generally accepted accounting principles were consistently applied. Holmes' report should make no reference to the consistent application of accounting principles.
3. When the auditor determines that informative disclosures are not reasonably adequate, the auditor must so state in the auditor's report.	3. Management is primarily responsible for adequate disclosures in the financial statements, but when the statements do not contain adequate disclosures the auditor should make such disclosures in the auditor's report. In this case both the statements and the auditor's report lack adequate disclosures.
4. The auditor must either express an opinion regarding the financial statements, taken as a whole, or state that an opinion cannot be expressed, in the auditor's report. When the auditor cannot express an overall opinion, the auditor should state the reasons therefor in the auditor's report. In all cases where an auditor's name is associated with financial statements, the auditor should clearly indicate the character of the auditor's work, if any, and the degree of responsibility the auditor is taking, in the auditor's report.	4. Although the Holmes report contains an expression of opinion, such opinion is not based on the results of a proper audit. Holmes should disclaim an opinion because he failed to conduct an audit in accordance with generally accepted auditing standards.

- 2-22**
- a. International auditing standards.
 - b. PCAOB auditing standards.
 - c. PCAOB auditing standards (reporting in the U.K. will be under international auditing standards).
 - d. Generally accepted auditing standards.
 - e. International auditing standards.
 - f. PCAOB auditing standards (due to the publicly-traded debt).

■ **Internet Problem Solution: International Auditing and Assurance Standards Board**

2-1 International Standards on Auditing (ISAs) are issued by the International Auditing and Assurance Standards Board (IAASB (<http://www.ifac.org/IAASB/>)). Visit the IAASB's website to answer the following questions:

1. What is the primary objective of the IAASB?

Answer:

The objective of the IAASB is to serve the public interest by setting high-quality auditing and assurance standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession. International Standards on Auditing (ISA) are used by auditors in countries that have adopted ISAs as their auditing standards.

2. What is the IAASB's due process that it follows when setting standards?

Answer:

The IAASB follows a due process in setting standards.

- The standards-setting Public Interest Activity Committees (PIAC) identify new projects based on review of international developments and consultation with the Public Interest Oversight Board.
- The project may be assigned to a task force, which considers whether to hold a public forum or roundtable.
- Draft pronouncements are exposed for a minimum of 90 days.
- The task force considers all comments and whether re-exposure is needed.
- The PIAC votes on the approval or withdrawal of the pronouncement. Affirmative vote of at least two-thirds of the members, but not less than 12, is required to approve an exposure draft.

Internet Problem 2-1 (continued)

3. The IAASB is committed to transparency. How does the IAASB make public information related to standards setting activities?

Answer:

The IAASB is committed to transparency. Where practicable, meetings are broadcast over the Internet or recorded. Meeting agendas and minutes are published on the International Federation of Accountants (IFAC) website. All exposure drafts are subject to public exposure for a minimum of 90 days.

(Note: Internet problems address current issues using Internet sources. Because Internet sites are subject to change, Internet problems and solutions may change. Current information on Internet problems is available at www.pearsonhighered.com/arens).