**NOTES 2**

**CPA FIRM AND AUDITING STANDARDS**

Notes that auditing plays important role to reduce information risk, it is the risk of making inappropriate decision due to the use of unreliable information, in this context is unreliable financial statements. The auditing standards are needed to ensure the quality of auditing performance which is conducted by CPA (Certified Public Accountants) through CPA Firms.

CPA FIRMS

CPA Firm is a firm or office which is used by CPA to deliver assurance and non assurance services in accounting field. The big four CPA firm in US are: (1) Deloite, (2) PricewaterhouseCoopers, (3) Earnst & Young, (4) KPMG. To open a CPA Firm, one must have certification as CPA. In US the CPA firm are classified into (1) big four international firms, (2) national firms, (3) regional and large local firms, and (4) small local firms. See table 2-1, page 46 Arens.

THE SERVICES OF CPA FIRMS

1. Audit services
2. Accounting and bookeeping services
3. Tax services.
4. Management consulting services.
5. Developing accounting information systems services.
6. Financial planning, business valuation, forensic audit, and information technology advisory services.

Assignment: give short description to each type of CPA firm services stated above.

THE STRUCTURE OF CPA FIRMS

**The main factors influence the organizational structure of CPA Firms:**

1. The need for independence from client.
2. The importance of a structure to encourage competence.
3. The increased litigation risk faced by auditors.

Assignment: give short description to each of the three reasons stated above.

**CPA Organizational Structure in US**

The regulation about the structure of CPA firm is depend on the country of the CPA firm. The form of CPA structure in US are:

1. Proprietorship
2. **General partnership**
3. General corporation
4. Professional corporation (PC)
5. Limited liability company (LLC)
6. Limited liability partnership (LLP)

Assignment: give short description to each type of the CPA Firm structure stated above.

SOX (SARBANES OXLEY ACT) AND PCAOB (PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD)

Trigerred by the bankcruptcies and alleged audit failures involving such companies as **Enron and WorldCom**, the SOX is considered to be the most important legislation affecting the auditing profession since the 1933 and 1934 Securities Acts. SOX established the Public Company Accounting Ovesight Board (PCAOB), appointed and overseen by the SEC.

The PCAOB provides oversight for auditors of public companies, establishes auditing and quality control standards for public company audits, and performs inspections of the quality controls at audit firms performing those audit. **The PCAOB conducts inspections** of registered accounting firms to assess their compliance with the rules of the PCAOB and SEC, professional standards, and each firm’s own quality control policies.

SECURITIES AND EXCHANGE COMMISION

The Securities and Exchange Commision (SEC), an agency of the federal government, assist in providing investors with reliable information upon which to make investment decisions.

The SEC Act of 1934 provide protection by requiring public companies and others to file detail annual reports with the commision. The commision examines these statements for completeness and adequacy before permitting the company to sell its securities through the securities exchanges.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (AICPA)

CPAs are licensed by the state in which they practice, but a significant influence on CPAs is exerted by their national professional organization, the AICPA.

AICPA sets standards and rules that all members and other practicing CPA must follow. Four major areas in which the AICPA has authority to set standards and make rules are as follows:

1. **Auditing standards.** The Auditing Standards Board (ASB) is responsible for issuing pronouncements on auditing matters in the US for **ALL ENTITIES OTHER THAN PUBLICLY TRADED COMPANIES.** ASB pronouncements are called Statements on Auditing Standards (SASs).
2. **Compilation and review standards**. This standards related to CPA’s responsibilities when a CPA is associated with financial statements of privately owned companies that are not audited. The name of standards is SSARS (Statements on Standards for Accounting and Review Services).
3. **Other attestation standards**. Statements on Standards for Attestation Engagements provide a framework for the development of standards for attestation engagements.
4. **Code of professional conduct**. TheAICPA Professional Ethics Executive Committee sets rules of conduct that CPAs are required to meet.

INTERNATIONAL AND US AUDITING STANDARDS

**International Standards on Auditing (ISA)**

ISAs are issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation fo Accountants (IFAC). IFAC is the worldwide organization for the accountancy profession, with 167 member organization in 127 countries, representing more than 2.5 million accountants throughout the world.

The IAASB works 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 by promoting their acceptance worldwide.

ISAs do not override a country’s regulations governing the audit of financial or other information, as each country’s own regulations generally govern audit practices.

**AICPA Aditing Standards**

Auditing standards for private companies and other entities in the US are established by the Auditing Standards Board (ASB) of AICPA, referred to as Statements on Auditing Standards (SASs). Because ASB has harmonized its agenda with the IAASB, the AICPA auditing standards are similar to ISAs, although there are some differences.

Prior to SOX, the ASB established auditing standards in the US for both private and public companies. The PCAOB now has responsibility for auditing standards for US public companies, while the ASB continues to provide auditing standards **for private companies and other entities**. The AICPA auditing standards are also referred to as US Generallay Accepted Auditing Standards (GAAS).

**PCAOB Auditing Standards**

The PCAOB initially adopted existing auditing standards established by the ASB as interim audit standards, however PCAOB considers international auditing standards when developing new standards, as a result, auditing standards for US public and private companies are mostly similar. Standards issued by the PCAOB are referred to as PCAOB Auditing Standards in the audit reports of public companies.

**Relation of US and International Auditing Standards**

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| --- | --- |
| International Auditing Standards (ISA) | Applicable to entities outside the US |
| AICPA Auditing Standards | Applicable to private entities in the US |
| PCAOB Auditing Standards | Applicable to US Public Companies and other SEC registrants |

**GENERALLY ACCEPTED AUDITING STANDARDS**

Historically, auditing standards have been organized along 10 GAAS, that fall into three categories: (1) general standards, (2) standards of field work, (3) reporting standards.

The principles of the standards is to provide a framework to help auditors fulfill the following two objectives when conducting an audit of financial statements:

1. Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework, and.
2. Report on the financial statements, and communicate as required by GAAS, in accordance with the auditor’s finding.

**GENERALLY ACCEPTED AUDITING STANDARDS – PCAOB INTERIM STANDARDS**

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| **General Standards**   1. The audit is to be performed by a person or persons having adequate technical training and proficiency as an auditor. 2. In All matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors. 3. Due professional care is to be exercised in the performance of the audit and the preparation of the report. |
| **Standards of Field Work**   1. The work is to be adequately planned and assistants, if any, are to be properly supervised. 2. A sufficient understanding of internal control is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed. 3. Sufficient appropriate evidential matter is to be obtained through inspection, inquiries, and confirmations to afford a reasobable basis for an opinion regarding the financial statements under audit. |
| Standards of Reporting   1. The report shall state wheter the financial statements are presented in accordance with generally accepted accounting principles (GAAP). 2. The report shall identify those circumstances in which such principles have not been consistently observed in the current period in relation to the preceding period. 3. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the reports. 4. The report shall contain either an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion can not be expressed, the reasons therefor should be stated. In all cases where an auditor’s name is associated with financial statements, the report sholud be contain a clear-cut indication of the character of the auitor’s work, if any, and the degree of responsibility the auditor is taking. |

LINKAGE AICPA AUDITING STANDARDS AND PCAOB GAAP (GENERALLY ACCEPTED AUDITING STANDARDS)

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| **Principles in AICPA Auditing Standards** | **PCAOB Generally Accepted Auditing Standards** |
| **Purpose of an Audit**   * Provide an opinion about the financial statements |  |
| **Reponsibilities**   * Possess appropriate competence and capabilities * Comply with ethical requirements * Maintain professional skepticism and exercise professional judgement | **General Standards**   * Adequate training and proficiency * Independence in mental attitude * Due professional care |

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| --- | --- |
| **Principles in AICPA Auditing Standards** | **PCAOB Generally Accepted Auditing Standards** |
| **Performance**   * Obtain reasonable assurance about whether financial statements are free of material misstatement * Plan work and supervise assistants * Determine and apply materiality level or levels * Identify and assess risks of material misstatement based on understanding of entity and its environment, including internal controls. * Obtain sufficient appropriate audit evidence | **Standards of Field Work**   * Proper planning and supervision * Independence in mental attitude * Due professional care |
| **Reporting**   * Express opinion on financial statements in a written report * Whether financial statements were presented fairly in accordance with financial reporting framework. | **Standards of Reporting**   * Whether statements were prepared in accordance with GAAP * Circumstances when GAAP not consistently applied * Adequacy of informative disclosures * Expression of opinion in written report |

**QUALITY CONTROL**

For CPA firm, quality control comprises of the methods used to ensure that the firm meets its professional responsibilities to clients and others. These methods include the organizational structure of the CPA firm and the procedures the firm establishes.

Quality control is closely related to but distinct from auditing standards. To ensure that the principles in auditing standards are followed on every audit, a CPA firm follows specific quality control procedures that help it meet those standards consistently on every engagement.

**ELEMENT OF QUALITY CONTROL FOR ACCOUNTING FIRMS**

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| **Element** | **Summary of Requirement** | **Example of a Pocedure** |
| Leadership responsibilities for quality within the firm (“tone at the top) | The firm should promote a culture that quality is essential in performing engagements and should establish policies and procedures that sport that culture. | The firm’s training programs emphasize the importance of quality work, and this is reinforced in performance evauation and compensation decisions. |

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| **Element** | **Summary of Requirement** | **Example of a Pocedure** |
| Relevant ethical requirements | All personnel on engagements should maintain independence in fact and in appearance, perform all professional responsibilities with integrity, and maintain objectivity in performing their professional responsibilities. | Each partner and employee must answer an “indepences questionnaire” annually, dealing with such things as stock ownership and membership on boards of directors. |
| Acceptance and continuation of clients and engagements | Policies and procedures should be established for deciding whether to accept or continue a client relationship. These policies and procedures should minimize the risk of associating with a client whose management lacks integrity. The firm should also only undertake engagements that can be completed with professional competence, | A client evaluation form, dealing with such matters as predecessor auditor comments and evaluation of management, must be prepared for every new client before acceptance. |
| Human resources | Policies and procedures should be establised to provide the firm with reasonable assurance that:   * All new personnel should be qualified to perform their work competently. * Work is assigned to personnel who have adequate technical training and proficiency. * All personnel should participate in continuing professional education and professional development activities that enable them to fulfill their assigned responsibilities. | Each professional must be evaluated on every engagement using the firm’s individual engagement evaluation report. |

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| **Element** | **Summary of Requirement** | **Example of a Pocedure** |
|  | * Personnel selected for advancement have the qualifications necessary for the fulfillment of their assigned responsibilities. |  |
| Engagement performance | Policies and procedures should exist to ensure that the work performed by engagement personnel meets applicable professional standards, regulatory requirements, and the firm’s standards of quality. | The firm’s director of accounting and auditing is available for consultation and must approve all engagements before their completion. |
| Monitoring | Policies and procedures should exist to ensure that the other quality control elements are being effectively applied. | The quality control partner must test the quality control procedures at least annually to ensure the firm is in compliance/ |

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